# SUPREME COURT OF THE UNITED STATES.

## OCTOBER TERM, 1917.

## No. 594.

## THE UNITED STATES OF AMERICA, PETITIONER.

vs.

## BIWABIK MINING COMPANY.

### INDEX.

a

No. 2938.

United States Circuit Court of Appeals, Sixth Circuit.

BIWABIK MINING COMPANY, PLAINTIFF IN ERROR,
*vs.*
THE UNITED STATES OF AMERICA, DEFENDANT IN ERROR.

No. 9180. Law.

Error from United States District Court, Northern District of Ohio, Eastern Division.

*Transcript of record.*

Messrs. Hoyt, Dustin, Kelley, McKeehan & Andrews, Cleveland, Ohio, attorneys for plaintiff in error.

Hon. E. S. Wertz, United States attorney, Cleveland, Ohio; F. B. Kavanagh, Esq., assistant United States attorney, Cleveland, attorneys for defendant in error.

Filed June 28, 1916. Wm. C. Cochran, clerk.

Office of the clerk, Supreme Court U. S. Received July 25, 1917.

Office Supreme Court U. S. Filed July 25, 1917. James D. Maher, clerk.

1 *Caption.*

UNITED STATES OF AMERICA,
*Northern District of Ohio, Eastern Division, ss:*

Record of the proceedings of the District Court of the United States within and for the Eastern Division of the Northern District of Ohio, in the cause and matter hereinafter stated, the same being finally disposed of at a regular term of said court begun and held at the city of Cleveland, in said district, on the first Tuesday in April, being the 4th day of said month, in the year of our Lord one thousand nine hundred and sixteen, and of the Independence of the United States of America the one hundred and fortieth, to wit, on Wednesday, the 24th day of May, A. D. 1916.

Present: Honorable John H. Clarke, United States district judge.

THE UNITED STATES OF AMERICA,
*vs.*
BIWABIK MINING COMPANY. } No. 9180. Law.

Said action was commenced on the 7th day of October, 1915, and proceeded to final disposition at the term and day above written, and during the progress thereof, pleadings and papers were filed, process was issued and returned, and orders of the court were made and entered in the order and on the dates hereinafter stated, to wit:

2 *Petition.*

Filed October 7, 1915.

The United States of America, by E. S. Wertz, United States attorney for the Northern District of Ohio, acting under authority of David A. Gates, Acting Commissioner of Internal Revenue, brings this action against the Biwabik Mining Company, hereinafter referred to as defendant, and says that the said defendant throughout the years 1909 and 1910 was and still is a corporation incorporated and organized for profit under the statutes of the State of West Virginia, in the United States of America, having a capital stock represented by shares, and having for its officers a president, vice president, with other principal officers, and a secretary and treasurer; that during said years the defendant was engaged in business for the purpose of making profits and dividends for its stockholders, the owners of its said shares, having and it still has its principal office and place of business in the city of Youngstown, in Mahoning County, Ohio, within said Northern District of Ohio, and within the 18th internal-revenue district of said State, where the principal business of the defendant during said years was and still is carried on.

Plaintiff says that as provided by section 38 of the act of Congress approved August 5, 1909, entitled: "An act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," which section 38 appears on pages 112 to 117, inclusive, of volume 36 of the Statutes at Large of the United States, the defendant made its report or return for the year 1909 on or before March first of the year 1910, and that the defendant made its report or return for the year 1910 on or before the first of March of the year 1911, both of said returns being for the respective preceding calendar years, as required by said section 38 of said act.

Plaintiff says that contrary to the provisions of said act, for the year ending December 31, 1909, the defendant filed an incorrect return in this, to wit, that the defendant did not include in its gross income for the year the amount of $245,289.00; that said amount was excluded under the pretence of covering the realization of unearned increment; that defendant filed an incorrect return for the year ending December 31, 1910, in this, to wit, that the defendant did not include in its gross income the amount of $265,372.08;
3 that said amount was excluded under the pretence of covering the realization of unearned increment.

Plaintiff says that the said amount for the year 1909 of $245,289.00 and the said amount for the year 1910 of $265,372.08 were wrongfully excluded from the gross income of the said years; that the said defendant had no right or authority in accordance with the provisions of section 38 of the said act of August 5, 1909, to exclude either of the said amounts from the item "gross income" in the said returns of "annual net income"; that the item "net income" on the return

for the year 1909 should have included the said amount of $245,289.00; that the item "net income" on said return for the year 1910 should have included the said amount of $265,372.08; that by reason of the said exclusion of the said items the defendant wholly failed and refused to pay the taxes as provided for in the said act of August 5, 1909, in the amount of $2,452.89 for the year 1909, and also in the amount of $2,653.72 for the year 1910.

That taxes for the year 1909 in the amount of $2,452.89 and taxes for the year 1910 in the amount of $2,653.72 were not assessed within the time fixed by the statute of limitations, and the defendant declined to execute a waiver as provided by law.

Plaintiff says the business of the defendant is the mining and production of iron ore; that defendant is not the owner of the lands upon which its mines are located; that the defendant has the right to mine said ore by virtue of the assignment to it of certain mineral leases; that said leases provide for the payment of royalties on each ton of iron ore mined from the said lands; that said royalties are paid by the defendant to the owners of the fee.

Plaintiff says that by reason of the foregoing and by reason of the provisions of section 38 of the said act of Congress approved August 5, 1909, the defendant is liable to the plaintiff and owes the plaintiff the sum of $2,452.89, being the taxes due the plaintiff for the year 1909, together with penalty and interest as provided by law; also in the sum of $2,653.72 for taxes as aforesaid for the year 1910, together with penalty and interest thereon as provided by law.

Wherefore plaintiff prays judgment against the defendant in the sum of $2,452.89, together with penalty and interest as pro-
4 vided by law, and also in the sum of $2,653.72, together with penalty and interest as provided by law, and the costs herein expended.

E. S. WERTZ,
*United States Attorney.*

STATE OF OHIO,
*Cuyahoga County, ss:*

E. S. Wertz, being duly sworn, says that he is the United States attorney for the northern district of Ohio, duly authorized in the premises, and that the allegations in the above petition are true, as he believes.

E. S. WERTZ.

Sworn to before me and subscribed in my presence this ——— day of September, 1915.

[SEAL.] F. B. KAVANAGH,
*Notary Public.*

*Praecipe.*

Filed October 7, 1915.

*To the clerk:*

Issue summons for the defendant The Biwabik Mining Company, directed to the United States marshal of this district, returnable

according to law. Endorse summons: "Action for money only; amount claimed, $2,452.89, together with penalty and interest as provided by law, and also in the sum of $2,653.72, together with penalty and interest as provided by law and the costs herein expended."

E. S. WERTZ,
*United States Attorney.*

5 *Answer.*

Filed November 30, 1915.

Now comes the defendant, and for answer to plaintiff's petition says:

Defendant admits that it was during the years 1909 and 1910 and for the purposes of this suit still is a corporation incorporated and organized for profit under the statutes of the State of West Virginia, having a capital stock represented by shares, and having the officers named in said petition, and that it was during said years 1909 and 1910 engaged in the business of mining and selling iron ore, and that its principal office and place of business was in Youngstown, Mahoning County, Ohio, within the eighteenth revenue district of the said State.

Defendant admits that as such corporation it made its reports or returns to the collector of internal revenue at Cleveland, Ohio, for the years 1909 and 1910, but defendant denies that its said reports or returns were incorrect in the manner set forth in said petition or in any other manner or respect whatsoever.

Defendant admits that its business during said two years and for a long time prior thereto was that of mining and producing iron ore; that it was not the owner of the lands upon which its mines were located; and that it mined and produced ore from said lands under and by virtue of the authority conferred upon it by certain contracts, under which it paid 30c per ton (and certain minimum sums when no mining was conducted) to the parties from whom it received its said contracts; and, further, defendant denies each and every other averment in the petition contained not hereinbefore expressly admitted or denied.

2. Defendant further says in answer to said petition that under and by virtue of contracts made and entered into by it in the month of June, 1898, this defendant, in consideration of $612,000 in cash paid by it, and certain promises and agreements in said contracts contained, became the owner of certain mining equipment of the value of $44,614.00 then located on certain premises in St. Louis County, Minnesota, and, in addition thereto, by said contract became vested with the exclusive right for the period of fifty years and three months to enter upon and explore said premises, and to mine and remove therefrom and sell and dispose of all the merchantable iron ore then on, in, or under said premises, upon payment by this
6 defendant, in installments from time to time, of 30c per ton for each ton so mined and removed; that prior to January 1, 1909,

defendant had fully explored said premises, and had developed large bodies of said iron ore, and had mined and removed therefrom large quantities thereof. On said January 1, 1909, said premises contained 6,874,695 tons of said iron ore, all of which can be easily mined and removed during the balance of the term of said contracts, and defendant's vested rights and estate in said premises and in said iron ore, exclusive of buildings and machinery, on said January 1, 1909, growing out of said contracts were of the value of $3,351,413.81, or 48¾c per ton; that in the calendar year 1909 defendant mined and removed from said premises and sold or otherwise disposed of 542,821 tons of said iron ore, and thereby converted into cash a pro rata amount of its capital assets and estate amounting to $264,625.23, and in the calendar year 1910 defendant mined and removed from said premises and sold or otherwise disposed of 544,353 tons of said iron ore and thereby converted into cash a pro rata amount of its capital assets and estate amounting to $265,372.08, no part of which said amounts was income within the meaning of said act of Congress for which defendant was liable to the excise tax of one per cent.

3. Defendant further says that the Commissioner of Internal Revenue and the Treasury Department of the United States, as required by section 38 of the act of Congress of August 5, 1909, caused to be prepared blank forms upon which annual reports and returns of corporations should be made, and likewise made various rules and regulations and decisions interpreting and construing said law, and caused the same to be promulgated as a guide to corporations in making their returns and reports thereunder; that this defendant made out and filed in the office of the collector of internal revenue in the city of Cleveland, Ohio, a report or return for each of said years 1909 and 1910 upon blanks so furnished to it by said collector.

4. Defendant further says that it made upon one of said blanks its report or return for the year 1909, showing thereon its entire gross receipts and net receipts, the latter being $318,986.09, from which latter amount it deducted the specific deduction permitted by law of $5,000, leaving total net receipts of $313,986.09, which said report was made by this defendant under protest. In said report there
7 was nothing deducted for or on account of the value of the ore mined out and disposed of during said year. The Commissioner of Internal Revenue assessed against this defendant the one per cent tax upon the net amount above shown, amounting to $3,139.86, which amount this defendant, under protest, paid to the said collector of internal revenue in the city of Cleveland on June 30, 1910, and this defendant thereby paid under protest the amount sued for herein for the year 1909.

5. That in the preparation of its report for the year 1910 this defendant ascertained and determined its gross income for said year by excluding from its gross receipts for said year the sum of $265,372.08, said sum representing the value of the capital assets of defendant as of January 1, 1909, disposed of and converted into money in said year 1910; that defendant made no concealment

thereof, but, on the contrary, showed the deduction by a rider attached to said return in the following words, to wit:

"The amount excluded from gross income for year ending December 31, 1910, to cover realization of unearned increment was $265,372.08."

Defendant further says that it intended by the term "unearned increment" to describe the value of the capital assets of defendant represented by said ore taken out and converted into money during said year 1910, and that while said term is inappropriately used, it is advised and believes that its said report as so made was in accordance with the instructions of said Treasury Department and conformed to the interpretation and construction then placed by the Treasury Department on said act of Congress and the rules and regulations of said Treasury Department, and as generally understood and acted upon by other corporations similarly situated. Said report and return was accepted by said Treasury Department as correct and as in compliance with said act of Congress and said regulations, and the excise tax of one per cent prescribed by said act of Congress was by the Commissioner of Internal Revenue assessed against this defendant upon $206,070.00, the amount of its net income as shown by said report (less $5,000 exemption provided in the law), and said defendant was in due time notified of the assessment thereon of $2,060.70, and, on June 30, 1911, paid the same.

6. Defendant further says that not until long afterwards, to wit, in October, 1914, and after the expiration of more than three
8 years, did the Treasury Department of the United States claim that the report and return as filed by this defendant for the year 1910 was incorrect or failed to comply with the said act of Congress in the respect set forth in the petition filed herein.

Second. For a further and additional defense, defendant says that it adopts as a part of this defense all the allegations and denials of this answer as fully as if herein again set forth at length, and further says that its rights and interests in the said premises and property, and the ore body thereon and therein as they existed on January 1, 1909, growing out of the contracts aforesaid, constituted capital assets of defendant as of said date, and that they were of the value hereinbefore set forth, and that the value thereof was reduced in each of said years respectively by the amounts aforesaid, and if defendant's report and return for the year 1910 as so made out and filed was wrong in not including said $265,372.08 in gross income for the year 1910 (which defendant denies), the plaintiff herein sustained no loss or damage by defendant's act aforesaid, as the amount thereof was in that event lawfully deductible as and for depreciation of property under the provisions of the act of Congress in that respect contained.

Wherefore defendant asks to be dismissed hence with its costs.

BIWABIK MINING COMPANY,
By HOYT, DUSTIN, KELLEY, MCKERRAN, & ANDREWS,
*Its Attorneys.*

THE STATE OF OHIO,
*Cuyahoga County, ss:*

Frank Billings, being first duly sworn, deposes and says that he is secretary of the Biwabik Mining Company, the defendant herein; that he has read the foregoing answer and knows the contents thereof; and that the statements and averments therein contained are true as he verily believes.

FRANK BILLINGS.

Sworn to and subscribed before me, this 30th day of November, A. D. 1915.

[SEAL.] E. L. MACCLOSKEY,
*Notary Public.*

9 *Reply.*

Filed February 8, 1916.

Now comes the plaintiff, and having first obtained leave so to do, files this its reply herein.

Plaintiff admits that defendant, under and by virtue of certain contracts made and entered into in the month of June, 1898, in consideration of $612,000.00 in cash paid by defendant, the defendant became the owner of mining equipment to the value of $44,614.00, then located on premises in St. Louis, Minnesota, as alleged in the answer, and in addition thereto defendant became vested with the exclusive right for the period of fifty years and three months to enter upon and explore the said premises and to mine and remove therefrom, and sell and dispose of all the merchantable iron ore then on, in, or under said premises, upon payment by the defendant of 30c per ton for each ton mined and removed, as alleged in the answer.

Plaintiff admits that, as alleged in the answer, prior to January 1, 1909, defendant had fully explored said premises, and had mined and removed large quantities thereof as alleged in the answer, and that on January 1, 1909, the premises contained 6,874,695 tons of said iron ore, and that the value of said iron ore and of said premises, exclusive of buildings and machinery on the said premises on January 1, 1909, growing out of the said contracts, were of the value of $3,351,413.81, or 48¾c per ton, as alleged in the answer; that in the calendar year 1909 the defendant mined and removed from the said premises 542,821 tons of said iron ore; that during the calendar year 1910 defendant mined and removed 544,353 tons of said iron ore.

Plaintiff admits, as alleged in paragraph 3 of the answer, that the Commissioner of Internal Revenue and the Treasury Department of the United States, as required by section 38 of the act of Congress of August 5, 1909, prepared blank forms upon which annual reports and returns of corporations should be made, and likewise made various rules and regulations and decisions for the purpose and as alleged in the said paragraph 3.

10 Plaintiff admits that the defendant made out and filed in the office of the Collector of Internal Revenue, in the city of Cleveland, a report or return for each of the said years 1909 and 1910, upon the blanks furnished by the Collector of Internal Revenue.

Plaintiff admits all allegations made by the defendant in paragraph 4 of its answer, as alleged in the answer, and that the defendant paid to the plaintiff $3,139.86 under protest to the said Collector of Internal Revenue on June 30, 1910.

Plaintiff admits that in the preparation of the report of the defendant for the year 1910, the defendant ascertained its gross income by excluding from its gross receipts the sum of $265,372.08, but denies that defendant did or could exclude the said sum as alleged in the answer.

Plaintiff admits that the defendant made no concealment of the said reduction, and admits that the rider was attached to the return made by the defendant, as alleged in paragraph 5 of its answer herein.

Plaintiff denies that the term "unearned increment" describes the capital assets of defendant represented by said iron ore and converted into money during said year 1910, and denies that the said reduction conformed to the interpretation and construction placed by the Treasury Department on said act of Congress, and the rules and regulations of the Treasury Department.

Plaintiff admits that the report and return was accepted by the Treasury Department, but denies that the said return was accepted as correct, or as in compliance with the said act of Congress and the regulations made thereunder.

Plaintiff admits that the excise tax of one per cent prescribed by said act of Congress was by the Commissioner of Internal Revenue assessed against the defendant upon $206,070.00, the amount of its net income as shown by its said report, and that defendant was notified of the assessment thereon of $2,060.70, and that on June 30, 1911, the defendant paid the same.

Plaintiff says that the said payment of $2,060.70 did not include the tax provided for in said act on the said item of $265,372.08, which was excluded by the defendant, as alleged in the petition.

Plaintiff admits that in October, 1914, and after the expiration of more than three years, that the Treasury Department of the United States claimed that the report and return as filed by the de-

11 fendant for the year 1910 was incorrect, or failed to comply with the said act of Congress in the respect set forth in the petition filed herein.

Plaintiff says that under the said act it acted wholly within its rights and within the law to make its said claim as alleged in the answer and as admitted herein. Save and except as hereinbefore specifically admitted, the plaintiff denies each and every allegation contained in the answer hereinbefore filed, save and except those which are admissions to allegations contained in the petition.

Wherefore plaintiff prays that it may have the relief asked for in its petition, and that the answer of the defendant may be dismissed at its costs.

E. S. WERTZ,
*United States Attorney.*

STATE OF OHIO,
*Cuyahoga County, ss:*

E. S. Wertz, being first duly sworn, says that he is the United States attorney for the Northern District of Ohio, duly authorized in the premises, and that the allegations in the above reply are true as he believes.

E. S. WERTZ.

Sworn to before me and subscribed in my presence this ——— day of February, 1916.

[SEAL.] F. J. DENZLER,
*Notary Public.*

*Statement as to agreed statement of facts.*

On February 3, 1916, an agreed statement of facts was filed in this case and is printed in this record as a part of the order of judgment and marked "Exhibit A."

12 *Waiver of jury.*

Filed February 11, 1916.

Now comes the plaintiff by its attorney, E. S. Wertz, and also comes the defendant by its attorneys, Hoyt, Dustin, and Kelley, and consent in writing to waive a trial of the above-entitled cause to a jury, and consent to submit the issues to the court without the intervention of a jury.

E. S. WERTZ, *Attorney for Plaintiff.*
HOYT, DUSTIN, KELLEY, MCKEEHAN & ANDREWS,
*Attorneys for Defendant.*

*Order approving bill of exceptions.*

Entered May 26th, 1916, by Judge Clarke.

Now comes the defendant and presents to the court its certain bill of exceptions in narrative form, which being found by the court to be true, is allowed, signed, and sealed, and is hereby ordered to be filed in this cause.

13 *Bill of exceptions.*

Filed May 26, 1916.

Be it remembered that at the April term, A. D. 1916, of said court, to wit, May 10th, 1916, this cause came on to be heard before the

Honorable John H. Clarke, judge of the District Court for the Northern District of Ohio, eastern division, the parties having waived, in writing, a trial by jury, and having consented that this cause should be heard and determined by the court without the intervention of a jury on an agreed statement of facts filed in this case.

Said agreed statement of facts, with the exhibits attached thereto, was all the evidence offered by either party on the trial of this cause.

The recopying of said agreed statement of facts is omitted from this bill of exceptions by agreement of both parties, but reference is hereby made to Exhibit A, attached to and made a part of the final judgment rendered in this case on the 24th day of May, 1916, wherein the court adopts said agreed statement of facts as a special finding of facts in this case, as appears of record herein, and said Exhibit A, attached to said final decree, is hereby made a part of this bill of exceptions in place of recopying the same at length herein.

Whereupon the parties submitted the case to the court for its decision on the issues and said agreed statement of facts.

Whereupon the court found that the defendant was entitled to deduct for and on account of the 544,353 tons of iron ore mined by it under its lease in the year 1910 the sum of .03885 cents per ton in its income-tax return for the year 1910, and that the defendant was not entitled to deduct the sum of 48.75 cents per ton deducted by it in its said return, and that there was due from the defendant to the plaintiff the sum of $2,442.23, with interest thereon at six per cent from the 30th day of June, 1911, all as appears by the record herein.

The court thereupon entered judgment on said findings, as appears of record herein, to all of which action of the court the plaintiff duly excepted.

Thereafter, within three days after the making of said finding and the entry of said judgment, the plaintiff filed its motion to set aside said judgment and for a new trial herein, for the reasons and upon the grounds therein set forth, as appears of record herein, which
14 motion was duly overruled by the court, to which action of the court the plaintiff duly excepted and now presents to the court this its bill of exceptions taken at the trial of said cause, which is allowed, signed, and sealed by the court, and made a part of the record of this cause.

In witness whereof the court has hereunto set his hand as so requested this 26th day of May, 1916, within the time allowed by the court for preparing and filing the same.

JOHN H. CLARKE,
*District Judge.*

Approved:
E. S. WHITE, *U. S. Attorney.*

*Opinion.*

Filed May 17, 1916.

Statement of the case.

The parties to this case waived, in writing, a trial by jury and submitted the cause upon an agreed statement of facts. Such of these facts as the court deems essential to a disposition of the case are as follows:

In the year 1898 the defendant, by assignment of a lease, acquired a leasehold estate in certain ore producing properties in the State of Minnesota, from which it mined ore from that date to and including the year 1910. For the year 1910 the defendant made a return to the collector of internal revenue of its gross income, and from this amount it deducted, "to cover realization of unearned increment," the sum of $265,372.08. The amount of this deduction was arrived at by multiplying the number of tons of ore mined during the year by 48½c., which was the market value of the ore in place on the premises on the first day of January, 1909, as estimated by the defendant, this being the date upon which the returns for taxation were to commence. It is stipulated that this deduction was made in good faith upon the claim that it was "a reasonable allowance for depreciation" of the property of the defendant for that year.

In June, 1911, payment was made in accordance with this return, but the Treasury Department about the month of October, 1914, after investigating the books and records of the defendant, made the claim that because the defendant was not the owner in fee of the premises from which it was mining ore, but was lessee of the same and was paying a royalty to the fee owners, it was not entitled to deduct anything for depletion of the ore body on the premises. Thereupon the defendant was requested to amend its return for the year 1910 so as to include in its gross income the amount of said deduction, which it declined to do, and thereupon this suit was instituted to recover the tax upon the amount of this deduction, amounting to $2,653.72.

Some time prior to the making of the return for the year 1910 the defendant estimated the tonnage and the market value of the ore in place upon the premises upon which it held its lease, which estimate gave to the ore in place a value of 48½c. per ton, exclusive of royalty.

The rights of the defendant in the iron ore mined in the year 1910 were derived from the assignment to it of a written lease dated April 4, 1898, by the Biwabik Bessemer Company, lessor. By the terms of that lease the defendant acquired the right for the term of fifty years and three months from the first day of May, 1898, to explore for, mine out, and remove the merchantable shipping iron ore

which might be found upon the lands described in the lease upon the payment of a royalty of 30c. for each ton mined. The expression "merchantable ore" is defined as including "all ores which grade 55% and above in metallic iron regardless of other ingredients."

The lessee contracted to mine and remove at least 300,000 tons of ore annually, or to pay to the lessor 30c. per ton on that amount if it should not be mined, but payments made in any year in excess of royalty on ore actually mined could be credited upon the excess which might be mined over the minimum requirement in subsequent years. Any failure to keep or perform any of the covenants or conditions of the lease gave to the lessor the option to take immediate possession of the premises.

The lessor in the lease reserved a lien upon any ore mined and upon all improvements for any unpaid balance of royalty,
16 and it was also provided in the lease that the lessee should have the right to terminate the lease on any first day of January during its term by giving ninety days' notice of the purpose and desire so to do.

The defendant, at the time it acquired this lease, paid to the prior lessee the sum of $612,000, in addition to contracting to pay the 30c. per ton royalty upon the ore mined, as has been stated.

It is stipulated in the agreed statement of facts that the deposit of ore on the leased premises is of such character that its quality and quantity were capable of determination "with extraordinary accuracy" by drilling and shafts, and that the defendant "by drilling and by standard recognized methods" had calculated the tonnage remaining on the land on January 1, 1909, as 6,874,695 tons, all of which could be easily removed within the term of the lease.

*Opinion.*

CLARKE, *District judge:*

The foregoing statement of the facts of this case makes it plain that the court is called upon to decide the question, "Was the estimated value of the ore which was mined in the year 1910, as the same was in place on January 1, 1909, a reasonable allowance for depreciation" of the property of the defendant within the terms of the act of Congress of August 5, 1909, permitting the deduction of such an allowance from the gross income of the company? And if this allowance be found not to be a proper one, then, "What allowance and deduction for depreciation, if any, should the defendant be permitted to make under the facts as stipulated in this case?"

We shall consider these questions in the order stated:

The Supreme Court of the United States in the case of Stratton's Independence, Ltd., vs. Howbert, 231 U. S., 399, decided that a mining corporation for the purpose of its tax return under the corporation excise tax law of August 5, 1909, could not lawfully deduct for depreciation from the proceeds of the ore mined the difference between the gross proceeds of the sales of ore during the year and the

expense of mining and marketing it. It was claimed that this difference represented the value to the mining company of the ore in place which had been mined, and that the value of the ore in place was
17 capital value and must be deducted from gross income in order to arrive at the net profits of the corporate operations for the year.

This decision seems in principle to cover and condemn the action taken by the defendant in the case at bar. In this case the amount deducted by the defendant was the value of the ore in place determined by the defendant as of January 1, 1909, upon the theory that the value of the ore in place was the capital of the company on the date from which the excise tax was to be computed, and that the net income of the company for the year 1910 could be arrived at only by deducting this capital value and the cost of operation and marketing from the gross amount received for the ore mined. No warrant is found in the language of the act for saying that the net profit for the year 1910 is to be arrived at by deducting from the gross receipts for the ore mined in that year the value of the ore in place as of January 1, 1909, plus the cost of the operation of the company, rather than that the value of the ore in place as of the first day of the year 1910 should be deducted. Indeed, if this principle of deducting the value of the ore in place as capital value is applicable at all it would seem to call for the deduction from the gross receipts of each year the value of the ore in place on the first day of that year rather than its value on the first day of the year 1909, for the reason that if it be capital value it may and probably would vary from year to year. It very certainly would vary if any considerable number of years are considered.

If such a deduction were to be made of the value of the ore in place as of the first day of each year it is very clear that the method condemned by the Supreme Court would be a much more accurate one for estimating the so-called capital value of the defendant than the method which it adopted, since the former is an accurate determination of the value of the ore in place to the owner, while the latter is at best an estimated value to be made by the indefinite opinions of experts.

There is no warrant in the language of the act and there does not seem to be any warrant in principle for deducting the estimated value of the ore in place rather than for deducting its actual value in place as determined in the way in which the Supreme Court has condemned, and therefore the action of the Supreme Court seemingly rules this case and calls for a rejection as unsound of the
18 method adopted and relied upon by the defendant. This is plainly the interpretation put upon this Supreme Court decision by the Circuit Court of Appeals of the 8th Circuit when in Stratton's Independence, Ltd., vs. Howbert, 211 Fed. Rep., 1023, that court affirms the decision by Judge Pope in the same case, 207 Fed. Rep., 419.

If, however, this interpretation of the Supreme Court decision should be thought broader than is justified, the same result must be arrived at even if we consider that that court in the decision referred to so hedged about its conclusions as to give no guide for the method of arriving at what is a "reasonable allowance for depreciation of property" in such cases as this one we are considering.

That prior to the passing of the act of August 5, 1909, the operation of mining companies was subject to peculiar but very definite treatment in the law when the net profits from the operation of such properties was under consideration, is clearly settled. In the Stratton case just referred to the Supreme Court of the United States uses this language:

"The peculiar character of mining property is sufficiently obvious. * * * As to the alleged inequality of operation between mining corporations and others, it is, of course, true that the revenues derived from the workings of mines result to some extent in the exhaustion of capital. But the same is true of the earnings of the human brain and hand when unaided by capital, yet such earnings are commonly dealt with in legislation as income. So it may be said of many manufacturing corporations that are clearly subject to the act of 1909, especially those that have to do with the production of patented articles."

This method of dealing with the income of mining properties was so well established that it found expression as familiar textbook law in Morawetz on Private Corporations, 2nd ed., sec. 442, as follows:

"The capital of a mining company is not designed to be used like that of a banking or manufacturing company in carrying on business permanently. The working of a mine necessarily causes it to become exhausted and to depreciate in value, and this depreciation can not be repaired. There would be no object in accumulating the money obtained by the company in working a mine to keep up
19 the original amount of the capital. It is implied from the character of the speculation of a mining company that the income derived from working the mine shall be distributed among the shareholders as dividends after deducting the expenses and making reasonable provision for contingencies.

To the same effect Thompson on Corporations, sec. 5316. People of the State of New York vs. Roberts, 156 N. Y., 585; Excelsior Water & Mining Company vs. Pierce, 90 Cal., 131; Commonwealth vs. Penna. Gas Coal Co., 62 Pa. St., 241. The rule is the same in England-Lee vs. Neuchatel Asphalte Co., 41 Ch., Div. 1, and cases cited in Stratton's Independence, Limited, vs. Howbert, 207 Fed., 419.

It must be assumed that the provision of the act of August 5, 1909, allowing a deduction from the gross income of corporations of "a reasonable allowance for depreciation of property," if any there was, in order to arrive at the "net income" to be taxed, was written having regard to the "peculiar character of mining property" and to the manner in which the courts had long dealt with the subject of capital depreciation in such cases as distinguished from their manner of

dealing with manufacturing or mercantile corporations and capital, and if this practice of the courts, as expressed in the authorities quoted, be applied to the case at bar, it results in the conclusion that the deduction made by the defendant to cover capital depreciation cannot be allowed. This conclusion also is directly supported by Stratton's Independence, Limited, vs. Howbert, 207 Fed. Rep., 422, affirmed by the Circuit Court of Appeals for the 8th Circuit, 211 Fed. Rep., 1023.

The fact that the defendant was a lessee and not the owner of the ore property it was operating strengthens this conclusion. The defendant had no title to the ore in place, its right being a chattel interest arising from the grant of the privilege of mining and removing the ore. Traer vs. Fowler, 144 Fed. Rep., 810 (to the point 815); Duffield vs. Hue, 129 Pa. St., 94; Duke vs. Hague, 107 Pa. St., 57; Nonamaker vs. Amos, 73 O. S., 163.

The agreed statement of facts shows no capital investment actually made by the defendant, excepting the $612,000 paid to its prior lessee, which will be hereinafter dealt with; the defendant paid only that amount for all of the ore upon the leased premises, and it contracted to pay an additional sum only if it mined and removed the ore; and it had the unrestricted right to surrender the lease on any first of January when it might prove profitable so to do because of inferior quality in the ore or because of unfavorable markets or mining costs, or from mere whim if it chose to do so.

The application of the method of capital maintenance and replacement adopted by the defendant to the entire tonnage mined and estimated in the leased lands would result in a capital replacement fund of almost precisely seven millions of dollars. The mere statement of this result condemns the process by which it is arrived at in a case in which no capital investment is shown, and it brings the case clearly within the principle of the Pennsylvania decisions which when inquiring as to "net profits" of mining, of oil, and of gas companies, refuse to permit any allowance for capital replacement, treating them as speculative enterprises.

Commonwealth vs. The Ocean Oil Co., 59 Pa. St., 61.

Commonwealth vs. Penna. Gas Coal Co., 62 Pa. St., 241.

The defendant relies chiefly upon the decisions in Mitchell Bros. vs. Doyle, 225 Fed. Rep., 437, and United States vs. Nipissing Mines Company, 202 Fed. Rep., 803. But in the former case the court was dealing with an owner of standing timber, and Judge Sessions pertinently says such property "is wholly unlike mineral ores in place under ground," and the latter case is obviously one where the defendant was the owner of the ore body, and in addition it seems to be a case of first impression on the part of a judge rendering a decision a year and a half before the decision in Stratton's Independence, Limited, vs. Howbert, 231 U. S., 399.

Proceeding upon the conclusion thus arrived at that the defendant could not lawfully make the deduction which it did make, there re-

mains to be considered only: What allowance and deduction, if any, should the defendant be permitted to make under the circumstances of this case?

The defendant paid $612,000 for the lease under consideration and in addition assumed the payment of the royalties stipulated for therein. This may properly and justly be considered a payment in advance of an increased royalty on ore to be mined, and that is precisely the character which the defendant gave to the payment when dealing with it in its private accounts, in which the stipulation shows, "Ex. H," that it carried one account, entitled "Rate of general ledger or capitalized value .03885 per ton," and another account
21 entitled "Rate of increment value, January 1, 1909, .44865 per ton." These two values added make the 48¾c per ton which the defendant deducted in making its return.

Thus in its own bookkeeping the defendant gives its private opinion as to the requisite reimbursement necessary to maintain its capital investment, and thereby is made applicable that long-standing rule for the construction of contracts, viz, "Show me what men have done under a contract and I will tell you what it means." The defendant should not complain if it be held to that construction of this lease and its investment under it which it adopted for purposes of its own accounting before the question of taxation had arisen to call forth ingenuity of interpretation.

It results that a decree will be entered allowing instead of the deduction computed on the basis of 48.75 cents per ton of ore mined, the sum of .03885 cents per ton, and there being no question of bad faith in the case, the ends of justice will be served by the payment of interest at the rate of 6% per annum from the date when the additional payment found due should have been made.

JOHN H. CLARKE, *Judge.*

CLEVELAND, OHIO, *May 17, 1916.*

22 *Judgment.*

Filed May 24, 1916.

This matter came on to be heard before the court, the attorneys for the plaintiff and the attorneys for the defendant having waived, in writing, a trial by jury herein, and having consented that this cause should be heard and determined by the court without the intervention of a jury on the pleadings and an agreed statement of facts, which was heretofore filed in this case and which the court hereby adopts as a special finding of facts herein and orders to be marked "Exhibit A," attached to and made a part of this judgment;

And the court finds as conclusions of law from said facts that the defendant was entitled to deduct for and on account of the 544,381 tons of iron ore mined by it under its lease in the year 1910, the sum of .03885 cents per ton (which amount the parties agree hereby is

the cost to defendant of said ore at the time it acquired the property in the year 1898, interest, taxes, surveys, and other carrying charges on the said ore up to the time of its removal from the said mine having been charged annually including the year 1910 into operating expenses), and defendant is not entitled to deduct the 48.75 cents per ton deducted by it in its return, and there is due from the defendant to the plaintiff the sum of $2,442.23, with interest thereon at 6% from the 30th day of June, 1911, the date when said sum should have been paid, and the court assesses the plaintiff's damages herein at $3,140.70, and judgment is hereby rendered against the defendant in favor of the plaintiff for the sum of $3,140.70, with interest from the first day of this term of court; to all of which findings and the judgment herein rendered the defendant at the time duly excepted.

JOHN H. CLARKE, *Judge.*

23

EXHIBIT A.

*Statement of agreed facts.*

Filed February 3, 1916.

To obviate the necessity of taking testimony, and for the purpose of this case, the parties plaintiff and defendant agree to and do hereby stipulate the following facts to be true, and consent that this case may be heard and determined on said facts:

1. Defendant was, in the years 1909 and 1910, and for many years prior thereto, a corporation duly organized for profit under the laws of the State of West Virginia, with its principal office in Youngstown, Ohio, having a capital stock represented by shares, and was engaged in the carrying on of the business of mining and selling iron ore from certain lands described as follows:

The northeast quarter of the northeast quarter and the southeast quarter of the northeast quarter of section 3, and the northwest quarter of the northwest quarter of section 2, township 58 north, of range 16 west, in St. Louis County, Minnesota.

2. Defendant's rights and interests in said property were acquired in the following manner:

(a) Under date of August 1, 1891, one J. M. Williams, of Chicago, Illinois, being then the owner in fee simple of the above premises, entered into a certain written contract with respect to said property, denominated a lease, with one John McKinley, of Duluth, Minnesota, a true copy of which (omitting therefrom acknowledgments and certificates of notary) is hereto attached, marked Exhibit "A," and made a part hereof.

Prior to March 26, 1898, the Biwabik Mountain Iron Company, a corporation, acquired the said foregoing lease from said John McKinley, and under date of March 26, 1898, said John M. Williams and Annie D. Williams, his wife, made and entered into a certain other written contract with respect to said same property, denominated a lease, with said Biwabik Mountain Iron Company, a true

copy of which (omitting therefrom acknowledgments and certificates of notary) is hereto attached, marked Exhibit "B," and made a part hereof.

(b) On or about April 4, 1898, said Biwabik Mountain Iron Company entered into a certain written contract with respect to said same property, denominated a lease, with the Biwabik Bessemer Company (a corporation), a true copy of which (acknowledg-
24 ments and certificates of notary omitted) is hereto attached, marked Exhibit "C," and made a part hereof.

(c) On June 23, 1898, said Biwabik Bessemer Company, in consideration of $612,000, paid to it by the defendant, Biwabik Mining Company, by written instruments sold and assigned to said defendant the contract of April 4, 1898, mentioned in No. "(b)" hereof, together with certain property mentioned in said written instrument, a true copy of which said instrument (acknowledgments and certificates of notary omitted) is hereto attached, marked Exhibit "D," and made a part hereof.

(d) All of said instruments hereinbefore mentioned were witnessed, acknowledged, and recorded as required by the laws of the State of Minnesota.

3. On or about June 23, 1898, with the approval and consent of said Williams, said defendant, under and by virture of the contracts aforesaid, entered into the possession of said premises and property and continued in the sole and exclusive possession thereof, and in the operation of the iron mines on said property, from that date down to and including the calendar years 1909 and 1910. The business of defendant during said years 1909 and 1910 was the mining and sale of iron ore from said premises.

4. The iron ore body on said property lies in a flat or blanket formation from about thirty to sixty feet below the surface, and the ore is mined by steam shovles after the removal of the surface. The boundaries of said ore body and the depth, quantity, and quality of said ore is capable of determination with extraordinary accuracy by test pits, shafts, and drilling from the surface. Prior to the year 1909 there had been mined and removed from said premises 7,420,114 tons of iron ore, and, in connection therewith, by drilling and by standard recognized methods, defendant had calculated the tonnage and the quality of the iron ore then still remaining upon said premises, and had ascertained that said property contained 6,874,605 tons of merchantable iron ore, all of which was readily and easily minable and removable before the expiration of the date of said contracts, in the year 1948.

5. In the condition said premises were in on January 1, 1909, the contract of April 4, 1898, and the rights created thereby, exclusive of buildings and machinery on said premises were o fthe actual value of $3,351,413.81, and the ore in said property, consider-
25 ing the entire deposit thereof en bloc, on January 1, 1909, was of the value of 48½c. per ton, exclusive of the royalty of 30c. per ton provided for in the lease.

6. Defendant mined and shipped from said property and sold or otherwise disposed of in the calendar year 1909, 542,821 tons of said iron ore, and during the calendar year 1910, 544,353 tons of said iron ore.

7. The Treasury Department of the United States from time to time issued and promulgated various regulations and decisions in respect to the said excise-tax law for the guidance of internal-revenue collectors and for the guidance of corporations in making their returns under said act of Congress, a true copy of which said regulations and decisions is hereto attached, marked "Exhibit E," and made a part hereof.

8. Said defendant, on the 14th day of March, 1910, made a return of its annual net income upon blanks furnished it by A. N. Rodway, collector of internal revenue, at Cleveland, Ohio, for that purpose, for the year ending December 31, 1909, a true copy of which is hereto attached, marked "Exhibit F," and made a part hereof; and likewise, on the 20th day of March, 1911, a return of the annual net income upon blanks furnished it by A. N. Rodway, collector of internal revenue, at Cleveland, Ohio, for that purpose, for the year ending December 31, 1910, a true copy of which is hereto attached, marked "Exhibit G," and made a part hereof. Subsequent to the filing of said return for the year 1909, to wit, after March 1, 1910, and prior to June 30, 1910, and subsequent to the filing of said return for the year 1910, to wit, after March 1, 1911, and prior to June 30, 1911, the Commissioner of Internal Revenue, having before him such returns, assessed against said defendant for the year 1909 an excise corporation tax of $3,139.86, being at the rate of one per cent on amount shown in item 11 of said return for said year, and likewise assessed against said defendant for the year 1910 an excise corporation tax of $2,060.70, being at the rate of one per cent on amount shown in item 11 of said return for said year, and defendant, on or before June 30, 1910, paid the tax so assessed for 1909 under protest, and, on June 30, 1911, paid the taxes so assessed for 1910. It is agreed that the full tax was paid for 1909, and the claim made in the petition for that year shall be disregarded.

9. The Biwabik Mining Company, as of January 1, 1909, made an estimate of the fair market value at that date of the minerals
26 in deposit on said property on the basis of the disposal value of the minerals in total, exclusive of the buildings and machinery, and reduced said valuation to the unit tonnage value, and prepared and has since maintained an official book record of the property owned by it in connection with which increment value is claimed, a copy of which said official book record was furnished to the department in connection with its claim and demand on said corporation for the amounts for which this action is brought, and before such action was commenced, and is hereto attached, marked "Exhibit H," and made a part hereof.

10. No objection was made by the Treasury Department to said return for the year 1910 until about the month of October, 1914, when

one of the officials of said department, after an investigation of the books and records of defendant, made the claim that, as defendant was not the owner of the fee to said premises, but operated the mines thereon under a contract or lease under which it paid royalty at the rate of 30c. per ton to the fee owners, it was not entitled to deduct anything for the depletion of the ore body on said premises by way of depreciation or otherwise, and defendant was thereupon requested to amend its said return for the year 1910, and include as gross income in said year the said sum shown on the rider attached to said return as made, and the claim was then made upon defendant that said amount was subject to the excise tax of one per cent. Defendant declined to amend its return as requested.

11. The gross receipts of defendant from all sources for the year 1910 (making due allowance for ore on hand on January 1, 1910) was..... $1,668,491.84

| | | |
|---|---|---|
| Defendant's expenses of operation for said year (which included the royalty at 30c. per ton paid on said contracts) were..... | $1,125,073.02 | |
| Depreciation on buildings, equipment, and furniture (no allowance having been included in this item for depletion or depreciation of ore body) was..... | 28,582.46 | |
| Taxes were..... | 38,384.18 | |
| | | 1,192,049.66 |
| Total net receipts..... | | 476,442.18 |

27 In making up its report for said year, defendant added to the item of gross receipts above ($1,668,491.84) the sum of the inventory of ore on hand on December 31, 1910, $53,143.86, making a grand total of $1,721,635.70, from which it deducted the sum of $265,372.08 (as and for the value [January 1, 1909] of the iron ore removed in the year 1910), and thus obtained the $1,456,263.62 shown as gross income in said report for 1910.

CONTENTIONS OF PARTIES.

(a) Plaintiff contends and submits to the court this case upon the two propositions following:

(1) That defendant, under the contracts herein set forth, was not the owner in fee of said premises but operated the same under a lease; that defendant, under the terms of said lease, paid royalty in installments at the rate of thirty cents per ton as said ore was removed, and that under said contracts defendant had no such rights or estate in said premises or in the ore body located thereon as entitled it to any deduction whatever from gross receipts or gross income for or on account of the iron ore mined, removed, and sold from said property.

(2) That if the defendant is entitled to make a deduction on account of depletion, the amount of such deduction shall be limited to a sum sufficient to return to the defendant the actual amount of its investment in the ore; that by the term "investment" as here used plaintiff includes the initial purchase price of the ore and all carrying charges, such as surveys, taxes, interest, etc. That is to say, when the defendant shall have been permitted to deduct from its gross income an amount on account of depletion which in the aggregate equals the investment as above defined no further deduction on that account is allowable.

(b) Defendant contends and submits to the court this case upon the two propositions following:

(1) That by the contracts set forth herein defendant acquired rights or interests in said premises and in the minerals in said land, the value of which on January 1, 1909, was capital assets within the meaning of said act of Congress, and that such value fixed the amount and value of defendant's capital assets and estate on said date, and that to the extent of the value of the ore mined and removed in 1910 (determined on the basis of the salable minerals on the property considered en bloc as of January 1, 1909, subject to the payment of 30 c. per ton when removed), such assets are changed in form
28 only from property into money by the removal and sale thereof, and that the amount of such value shall be deducted from gross receipts of defendant in 1910 before ascertaining defendant's gross income from business for such year.

(2) That if wrong in the foregoing proposition, and if it was the duty of the defendant under said act of Congress to treat in its report or return its entire gross receipts as "gross income," nevertheless the ore mined and sold in 1910 from said property reduced pro tanto the value of the capital assets or estate of defendant as they existed in said property on January 1, 1909, and the amount thereof was in any event deductible as depreciation under the provisions of said act of Congress.

13. The amount claimed under the petition in this case is one per cent upon the sum deducted by defendant in its return for 1910. No question is here made by the parties to this suit as to the amount, but only as to the right of deduction, and judgment shall be entered herein for plaintiff or defendant accordingly as the court shall find for the plaintiff or defendant upon the contentions aforesaid.

14. The stipulations herein made are not intended to cover the plaintiff's claim for interest and penalties, but that matter, being a question of law, is left to the court.

O. K. E. S. WERTZ,
*Solicitor for Government.*
A. C. DUSTIN,
*Solicitor for Defendant.*

EXHIBIT "A."

This indenture made this first day of August, A. D. one thousand and eight hundred and ninety-one, by and between J. M. Williams, of Chicago, State of Illinois, party of the first part, and John McKinley, of Duluth, State of Minnesota, party of the second part.

Witnesseth that the party of the first part, in consideration of the sum of one dollar (1.00) to him in hand paid by the party of the second part, the receipt whereof is hereby acknowledged, and in further consideration of the covenants and conditions herein contained, to be kept and performed by the party of the second part, does hereby contract, lease, and demise to the party of the second part for a term of years from and after the 1st day of August, one thousand eight hundred and ninety-one, during and until
29 A. D. one thousand nine hundred and eleven, the following-described lands, situated in the county of St. Louis, in the State of Minnesota, viz:

Lots two (2), three (3), and four (4) in section two (2), and lot one (1), and southeast quarter (S. E. ¼) of northwest quarter (N. E. ¼) of section three (3), and lots one (1) and two (2) and southeast quarter (S. E. ¼) of northeast quarter (N. E. ¼) and east half (E. ½) of the southeast quarter (S. E. ¼) and northwest quarter (N. W. ¼) of southeast quarter (S. E. ¼) of section four (4), in township fifty-eight (58), range sixteen (16) west; also southwest quarter (S. W. ¼) of southwest quarter (S. W. ¼) of section thirty-four (34) and southwest quarter (S. W. ¼) of southwest quarter (S. W. ¼) of section thirty-five (35), in township fifty-nine (59) N., range sixteen (16) W., which premises are leased to the party of the second part for the purpose of exploring for mining, taking out and removing therefrom, the merchantable iron ore, which is or which hereafter may be found on, in, or under said land, together with the right to construct all buildings, make all excavations, openings, ditches, drains, railroads, wagon roads, and other improvements upon said premises, which are or may become necessary or suitable for the mining or removal of iron ore from said premises.

Provided, however, that the party of the second part shall have the right at any time to terminate this agreement in so far as it requires the party of the second part to mine ore on said lands, or to pay a royalty therefor, by giving written notice to the party of the first part, who shall in writing acknowledge the receipt of said notice, and the foregoing lease shall terminate ninety (90) days thereafter, and all arrearages and sums which may be due under the same up to the time of its termination, as set forth in such notice shall be paid within ten days after such termination of lease.

The party of the first part further agrees that the party of the second part shall have the right under this agreement to contract with others to work such mine or mines, or any part thereof, or to subcontract the same, and the use of said land, or any part thereof, for

the purpose of mining iron ore, with the same rights and privileges as are herein granted to the said party of the second part. The party of the second part, in consideration of the premises, hereby covenants and agrees to and with the party of the first part that the party of the second part will, on or before the tenth (10) day of April,
30 July, October, and January in each year, during the period hereinbefore stipulated or during the period this contract continues in force, pay to the first party for all the iron ore mined and removed from said land during the three (3) months preceding the first (1) day of the month in which payment is to be made, as aforesaid, at the rate of thirty cents per ton, for all iron ore so taken out, mined, and carried away, each ton to be reckoned at twenty-two hundred and forty (2240) pounds.

The party of the second part, at the time of such payment, shall transmit to the first party an exact and truthful statement of the amount of iron ore removed during the three (3) months for which such payment shall be made. The iron ore so taken by the party of the second part from said land, shall be weighted by the railroad company transporting the same from said land, which weight shall determine the quantity as between the parties thereto.

Said party of the second part shall furnish the first party monthly statements showing the aforesaid weights; the right, however, is hereby conceded to the party of the first part, by its duly authorized agents, to inspect, review, and test the correctness of said railroad company's scales and weights at any time, and in such manner as may seem proper to adopt, it being understood that any errors in these respects, when ascertained, shall be cognizable and corrected, and any such difference shall be settled and paid for at the next regular quarterly payment.

It is understood and agreed between the parties that within thirty (30) days after this lease is executed a satisfactory estimate to both parties shall be made of the pine stumpage (or amount of pine) contained upon said land described in this lease and such amount of stumpage thus agreed upon and also other timber upon said land, the party of the second part agrees with the party of the first part to save him harmless from loss thereof by fire, up to July 1st, 1892, at which time said estimated amount of pine is to be paid for in cash by said second party to said first party at the rate of four dollars ($4.00) per thousand feet, unless said second party before that time, under the terms of the lease, abandons all of said mining lands described hereon. All other timber upon said land is to be used for mining and building purposes by party of second part, for the use of said mines, free and without charge.

31 It is further agreed between said parties that from the first of July, 1892, the yearly output of iron ore from said lands shall be estimated at not less than ten thousand gross tons per year, and that minimum amount of royalty shall be paid as per lease to party of first part, one-half the first of July, and one-half the first

of January of each year, whether the same is mined and shipped from said mine or not, and a failure to pay said royalty at the time specified shall constitute an abandonment of said mines or lease, at option of the party of the first part.

Said second party is to pay all taxes and assessments levied upon said lands embraced in this lease during the continuance of same unless terminated upon the conditions herein expressed.

The usual quarterly payments provided herein for previous ore shipments are required to be paid at Chicago, Illinois, in current bank notes or drafts at par, payable to the order of party of first part or his heirs or assigns, at such place therein as party of first part may direct.

It is mutually understood and agreed that upon the termination of this agreement, whether by the acts of the parties or either of them, or by limitation, the party of the second part shall have sixty (60) days in which to remove all engines, tools, machinery, railroad tracks, and structures erected or placed by said party on said land, if all dues are paid and other conditions performed, but shall not remove or impair any supports placed in the mines nor any timbers or framework necessary to the use and maintenance of the shafts or other approaches to the mines or tramways within the mines.

The party of the first part expressly reserves to himself (and the party of the second part assents thereto) the right by its duly authorized agents to enter into and upon the above-described premises, and any part or parts thereof, at any time or times to inspect and survey the same and measure the quantity of ores that shall have been mined or removed therefrom, not unnecessarily or unreasonably hindering or interrupting the operations of the lessees.

The covenants, terms, and conditions of this lease shall run with the land and be in all respect binding and operative upon all sublessees and grantees under the party of the second part.

It is further provided that the present lease is granted upon
89 the express condition that if said royalty or any part thereof be and remain unpaid after the days and times herein specified, and if the same remain in default for a period of thirty days, or in case the party of the second part fail to keep and perform any of the covenants or conditions herein expressed to be kept and performed by said party of the second part, then, and from thence forth and in either of these events, shall be lawful for the party of the first part at its own option to take possession of the said leased premises, with or without any previous notice or process whatever to reenter, and to have and possess again as fully as though no lease had been given to said party of the second part, and they and all parties claiming under them shall be wholly excluded therefrom.

The party of the first part reserves and shall at all times have, possess, and hold a lien upon all ore mines and on all improvements made on said premises by the party of the second part for any unpaid balances due on this contract.

To further protect said first party in his property rights under this lease it is expressly understood and agreed between said parties that this lease shall not be transferred or assigned to any other party or parties without the written consent by said first party to such transfer or assignment.

In witness whereof, the parties hereto have signed their names and affixed their seals on the day and year first above written.

JOHN M. WILLIAMS. [SEAL.]
JOHN MCKINLEY. [SEAL.]

Witness for John M. Williams.
(Signed) W. J. HOPKINS, J. D. WATSON.
Witness for John McKinley.
(Signed) HORACE WILLISTON,
(Signed) CHARLES E. MARSDEN.

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EXHIBIT "B."

This indenture, made this 26th day of March, A. D. 1898, by and between John M. Williams and Annie D. Williams (husband and wife), of Chicago, Illinois, as parties of the first part, hereinafter designated the "lessors," and Biwabik Mountain Iron Company, a corporation duly created, organized, and existing under the
33 laws of the State of Minnesota, as party of the second party, hereinafter designated the "lessee," witnesseth:

That said lessors, in consideration of the sum of one dollar to them in hand paid by said lessee, the receipt whereof is hereby acknowledged, and in further consideration of the covenants, promises, and conditions hereinafter contained, to be kept and performed by said lessee, do hereby contract, lease, and demise unto said lessee, its successors and assigns, for a term of years beginning on the first day of August, A. D. one thousand nine hundred and eleven, and ending on the first day of August, A. D. one thousand nine hundred and forty-eight, the following described lands, to wit:

"Situated in the county of St. Louis and State of Minnesota, and known and designated as the northeast quarter of the northeast quarter (sometimes designated as 'lot one') and the southeast quarter of the northeast quarter of section three; and the northwest quarter of the northwest quarter (sometimes designated as 'lot four') of section two, in township 58, north of range 16 west."

Said lands are leased by said lessors to said lessee for the purpose of exploring for, and mining, taking out and removing therefrom merchantable iron ore, which is, or which hereafter may be found on, in, or under said lands; together with the right to construct all buildings, and to make all excavations, openings, drains, ditches, railroads, wagon roads, and other improvements upon said premises which are or which may become necessary or suitable for the mining or removal of the iron ore from said premises.

Provided, however, that said lessee, its successors or assigns, shall have the right, at any time, upon ninety days' notice, to terminate this lease, in so far as it requires said lessee to mine ore on said lands, or to pay royalty therefor, by giving written notice to said John M. Williams, his heirs, assigns, or representatives, who shall in such case acknowledge, in writing, the receipt of such notice, and this lease shall terminate ninety (90) days thereafter. And the arrearages and sums which may be due under this lease up to the time of its termination as set forth in such notice shall be paid within ten days after such termination of this lease.

The said lessors hereby further agree that said lessee, its successors and assigns, shall have the right, under this contract, to contract with others to work such mine or mines, or any part thereof, as now
34 are or may be upon said premises, or any part thereof, and to subcontract the same, and the use of said lands, or any part thereof, for the purpose of mining iron ore, with the same rights and privileges as are herein granted to said lessee.

The said lessee, for itself, its successors and assigns, hereby covenants and agrees to and with said lessors, that it, the said lessee, will, on or before the 15th day of each January, March, May, July, September, and November, of the aforesaid term of thirty-seven years covered by this lease, or during the period of time for which this contract continues in force, pay to said John M. Williams, or his representatives or assigns, for all of the iron ore which shall be mined and removed from said lands during the two calendar months next preceding the first day of the month in which payment is to be made as aforesaid, at the rate and price of twenty cents per ton for all iron ore so taken out, mined, and carried away from said premises, each ton to be reckoned at 2,240 pounds.

The said lessee, its successors and assigns, at the time of making each of said payments, shall transmit to said John M. Williams, his representatives or assigns, an exact, truthful statement of the amount of iron ore removed from said land for the two calendar months for which such payment is to be made. The iron ore so taken by said lessee, its successors or assigns, from said lands shall be weighed by the railroad company transporting the same from said lands, which weights shall determine the quantity as between the parties hereto.

Said lessee, its successors or assigns, shall furnish said John M. Williams, his representatives or assigns, monthly statements, showing the aforesaid weights; the right, however, is hereby conceded to said parties of the first part, by their duly authorized agents, to inspect, view, and test the correctness of said railroad company's weights at any time and in such manner as may seem proper to adopt, it being understood that any errors in these respects, when ascertained, are to be cognizable and corrected, and any such difference shall be settled and paid for at the next regular bimonthly payment.

Said lessee, its successors and assigns, are to have the right to use any timber which may be upon said lands, for mining and building purposes, and for the use of said mines free and without charge.

Said lessee, for itself, its successors and assigns, hereby cove-
35 nants and agrees with said lessors that during each and every year of the period or term covered by this lease, or until the abandonment of this lease, it, the said lessee, will mine and remove from said leased premises at least three hundred thousand tons of iron ore annually—or that it will pay to said John M. Williams, his representatives or assigns, a royalty of twenty cents per ton on said minimum quantity each year, the same as if actually mined and removed.

If upon the 15th day of any January, ensuing the beginning of the term of this lease, it shall appear that during the year preceding the first day of that month, the minimum annual quantity of three hundred thousand tons of ore has not been mined and removed from said lands, then, and in every such case, said Biwabik Mountain Iron Company, shall pay to said Williams a sum of money equal to the difference between the amount of the royalty, at twenty cents per ton, on the ore actually mined and removed during such year, and sixty thousand dollars, so that the royalties to be received by said Williams shall for each year, amount to at least sixty thousand dollars.

If for any year or years of the life of this contract, said party of the second part shall thus pay moneys in excess of the royalty on ore actually mined and removed from said premises during such year or years, then such moneys, so paid in excess of the royalty on ore actually mined and removed, shall be credited and applied as payments of royalties on ore, which may be mined and removed from said premises during any subsequent year or years, in excess of the stipulated minimum annual quantity of three hundred thousand tons.

Said lessee is to pay all taxes and assessments which may be levied upon the lands embraced in this lease, during the continuance of the same, unless terminated upon conditions herein expressed.

The several payments required by this contract to be made shall be made at Chicago, Illinois, in current bank notes or drafts at par, payable to the order of said John M. Williams or his representatives or assigns at such place in said city as said John M. Williams or his representatives or assigns may, from time to time, in writing, designate.

It is mutually understood and agreed that upon termination of this lease, whether by the acts of the parties, or either of them, or by expiration of the term, the lessee, its successors or assigns, shall have sixty days within which to remove all engines, tools,
36 machinery railroad tracks, and structures erected or placed by them upon said premises, if all dues are paid, and other conditions performed.

But they shall not remove or impair any supports placed in the mines, nor any timber or framework necessary to the use or maintenance of the shafts, or other approaches to the mines, or the tramways within the mines.

The said lessors expressly reserve to themselves (and said lessee assents thereto), the right, by their duly authorized agents, to enter into and upon the above described lands, or any parts thereof, at any time or times, to inspect and survey the same, and to measure the quantity of ore that shall have been mined or removed therefrom—not unnecessarily or unreasonably hindering or interrupting the operation of the lessee.

The covenants, terms, and conditions of this lease shall run with the land, and be in all respects binding and operative upon all sublessees and grantees under the party of the second part.

It is further provided that the present lease is granted upon the express condition that if said royalty, or any part thereof, be and remain unpaid after the days and times herein specified—and if the same remain in default for a period of thirty days; or in case the party of the second part fails to keep any of the covenants or conditions herein expressed; to be kept and performed by said party of the second part, then and from thenceforth, and in either of those events, it shall be lawful for the parties of the first part, at their own option, to take possession of the said leased premises, with or without any previous notice or process whatever, to reenter and to have and possess again as fully as though no lease had been given to said party of the second part, and they, and all parties claiming under them shall be wholly excluded therefrom.

The parties of the first part reserve, and shall at all times have, possess, and hold a lien upon all ore mined, and on all improvements made on said premises by the party of the second part, for unpaid balances due on this contract.

Said Biwabik Mountain Iron Company is the owner of that lease-hold estate in said lands, which was originally granted by said John M. Williams to John McKinley, by lease dated August 1st, 1891, and recorded in the office of the register of deeds of St. Louis County, Minnesota, in Book 1 of Agreements, at pages 354 et seq.—
37 which lease-hold estate will expire August 1st, 1911, and it is hereby expressly provided, as a condition of this lease, that if, during each and every year of said preexisting lease, to wit, during each and every year ensuing from January 1st, 1898, down to August 1st, 1911, at least three hundred thousand tons of ore shall not be mined from said lands, or paid for at the rate of twenty cents per ton royalty as though mined, then this lease shall become null and void, and thereupon said party of the second party, its successors and assigns, shall have and claim no rights hereunder.

To further protect said party of the first part in his property rights under this lease, it is expressly understood and agreed between said parties, that this lease shall not be assigned or transferred to any other party or parties, or corporations without the written consent of said party of the first part to such transfer or assignment.

In testimony whereof, the above-named John M. Williams and Annie D. Williams have set their hands and seals to duplicates

hereof, and said Biwabik Mountain Iron Company has caused its corporate name and seal to be subscribed and affixed to said duplicates the day and year first above written.

JOHN M. WILLIAMS. (SEAL.)
ANNIE D. WILLIAMS. (SEAL.)

Signed, sealed, and acknowledged by John M. Williams and Annie D. Williams in our presence.

PARKE E. SIMMONS.
CHAS. D. BLANEY.

BIWABIK MOUNTAIN IRON COMPANY,
By WILLIAM J. OLCOTT, *President.*

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EXHIBIT "C."

This indenture, made this fourth day of April, A. D. 1898, between the Biwabik Mountain Iron Company, a corporation organized under the laws of the State of Minnesota (hereinafter called the lessor), party of the first part, and Biwabik Bessemer Company, a corporation organized under the laws of the State of Minnesota (hereinafter called the lessee), party of the second part, witnesseth, as follows:

First. That said lessor, in consideration of one dollar to it in hand paid by said lessee, the receipt of which is hereby ac-
38 knowledged, and in further consideration of the covenants, provisions, and conditions hereinafter written, to be kept and performed by said lessee, does hereby let, lease, and demise to said lessee for the term of fifty years and three months, beginning on the first day of May, A. D. one thousand eight hundred and ninety-eight, and ending on the first day of August, A. D. one thousand nine hundred and forty-eight, the following described parcels of land, to wit:

"Situated in the County of St. Louis, State of Minnesota, and described as follows: The northeast quarter of the northeast quarter (sometimes designated as lot one) and the southeast quarter of the northeast quarter of section three, and the northwest quarter of the northwest quarter (sometimes designated as lot four) of section two, township fifty-eight north, of range sixteen west."

Subject, nevertheless, to the right of way of the Duluth, Missabe & Northern Railway Company upon and over said premises, and to the instruments hereinafter specifically mentioned as affecting said premises.

The said premises are demised and leased to said Biwabik Bessemer Company for the purpose of exploring for, mining, taking out, and removing therefrom the merchantable shipping iron ore, which is, or which may hereafter be found, on, in, or under said lands, together with the right to construct all buildings, make all excavations,

openings, ditches, drains, railroads, wagon roads, and other improvements upon said premises, which are, or which may become necessary or suitable for the mining or removal of iron ore from said premises. Provided, however, that said lessee, its successors or assigns, if up to that time it shall keep the provisions hereof on its part, shall have the right to terminate this lease on any first day of January during the term by giving said lessor, or its successors or assigns, at least ninety days previous notice in writing, ending on the ensuing first of January, of the purpose and intention to terminate the same, and by surrendering possession of said leased premises and paying all sums then due under this lease, including royalty for ore then removed falling due at the next ensuing bimonthly period and a proportionate part of the year's minimum royalty in so far as royalty paid for ore actually removed shall fall short of such minimum.

The said lessor further agrees that said lessee shall have the right, under this agreement, to contract with others to work
89 said mine or mines, or any part thereof, or to subcontract the same or the use of said land or any part thereof, for the purpose of mining iron ore therefrom, with the same rights and privileges as are herein granted to said lessee.

Second. The lessee, in consideration of the premises, hereby covenants and agrees to and with the lessor that it, the said lessee, will, on or before the 15th day of March, May, July, September, November, and January of each year during the term of this lease, or during the period for which it shall remain in force, pay to the lessor, for all the merchantable iron ore mined and removed from said land during the two calendar months preceding the first day of the month in which payment is to be made, as aforesaid, at the rate of thirty cents per ton, for all the iron ore so taken out, mined, and removed, each ton to be reckoned at 2,240 pounds. The lessee, at the time of making each bimonthly payment, shall transmit to the lessor an exact and truthful statement of the amount of iron ore removed during the two months for which such payment is to be made. The ore so removed by the lessee shall be weighed by the railroad company transporting the same from said lands, which weights shall determine the quantity as between the parties hereto. Said lessee shall also furnish said lessor monthly statements showing the aforesaid weights, but nevertheless the right is hereby conceded to both parties, by their respective authorized agents, to inspect, review and test the correctness of said railroad company's scale and weights, at any time, and in such manner as may be proper, and it is understood that any errors in respect to such weights, when ascertained, shall be recognized and corrected, and any such differences shall be settled for at the time of the next regular bimonthly payment.

The term "merchantable ore," wherever used in this contract, shall include all ores which grade fifty-five per cent and above in metallic iron, regardless of the percentage of other ingredients.

Third. The lessee shall, during the continuance of this contract, have the same right to cut and use timber on said lands which the lessor itself has under the terms of its lease of said premises from John M. Williams, the fee owner.

Fourth. Said lessee covenants and agrees that during each and every year (reckoning, for this purpose, from the 1st day of January, 1898) of the term covered by this lease, or until this lease shall have been terminated, it, the said lessee, will mine and remove from said leased premises at least three hundred thousand tons of iron ore annually, or that it will pay to said lessor the royalty of thirty cents per ton on said minimum quantity each year, the same as if actually mined and removed.

If, upon the 15th day of January ensuing the commencement of the term of this lease, it shall appear that during the year preceding the first day of that month the minimum quantity of three hundred thousand tons of iron ore has not been mined or removed from said lands, then, and in every such case, said lessee shall pay to said lessor a sum of money equal to the difference between the amount of the royalty, at thirty cents per ton, on the ore actually mined and removed during such year, and ninety thousand dollars. If for any year or years of the life of this lease said lessee shall thus pay moneys in excess of royalties on ore actually mined and removed from said premises during such year or years, then such moneys so paid in excess of the royalties on ore actually mined and removed shall be credited and applied as payment of royalties on ore which may be mined and removed from said premises during any subsequent year or years in excess of the stipulated minimum quantity of three hundred thousand tons.

All rents and royalties which, by the terms of this lease, are required to be paid by the lessee, shall be payable to the lessor at such place as the lessor shall from time to time designate in writing, and until further notice shall be paid at the office of the treasurer of the lessor in the city of New York.

Fifth. The lessee is to pay all taxes and assessments levied on said lands or on the ores mined therefrom during the continuance of this lease, which taxes and assessments shall be paid before the same shall become delinquent, and the lessee will, on application, furnish the lessor with copies of analyses and all information connected with further exploration or development work on the demised premises; but failure to furnish such analyses or information shall not work forfeiture of this lease.

Sixth. Said Biwabik Mountain Iron Company holds its estate in said lands under and by virtue of two leases granted to it by John M. Williams, the fee owner, one of which leases will expire on August first, 1911, and the other on August first, 1948. And therefore said Biwabik Mountain Iron Company hereby covenants and agrees with said Biwabik Bessemer Company that it will promptly pay to said John M. Williams, or his proper heirs, legal

representatives or assigns, the rents and royalties which from time to time shall become due under said paramount leases, so as at all times to protect said leasehold estate from forfeiture.

Seventh. Said lessor expressly reserves to itself the right, by its duly authorized agents, to enter into and upon the above-described premises, or any part or parts thereof, at any time or times, to inspect and survey the same and to measure the quantity of ore that shall have been mined upon or removed therefrom, not unnecessarily or unreasonably hindering or interrupting the operations of the lessee.

Eighth. This lease is granted upon the express condition that if the royalty, or any part thereof, called for by the terms of this contract shall remain unpaid after the times and days herein specified for payment, and if the same shall remain in default for a period of thirty days, or in case the lessee shall fail to keep and perform any of the covenants or conditions herein expressed to be kept and performed by it, then and from thenceforth and in every such event it shall be lawful for the party of the first part, at its option, to take possession of said leased premises, with or without any previous notice or process whatever, and to reenter and have and possess said premises as fully as though this lease had not been given, and said lessee and all parties claiming under it shall be wholly excluded therefrom, and in the event of the termination of this lease under the provisions of this article hereof the lessee shall remain liable for so much of the minimum royalty reserved for that whole year as shall then remain unpaid.

Ninth. Said lessor hereby reserves and shall at all times have, possess, and hold a lien upon the ore mined and upon the improvements made upon said premises for any unpaid balances due to it under this contract.

Tenth. Upon the termination of this lease, whether by the acts of the parties, or either of them, or by limitation, said lessee shall have sixty days in which to remove all engines, tools, machinery, railroad tracks, and structures erected or placed by it upon said premises, if all dues are paid and other conditions required of said lessee by this lease are performed, but said lessee shall not remove or impair any supports placed in the mines nor any timbers or framework necessary to the use or maintenance of the shafts or other approaches to the mines or tramways within the mines.

Eleventh. The lessor has heretofore, by several instruments dated February 2nd, 1892, entered into a traffic contract with the Duluth, Missabe & Northern Railway Company and given its bonds to said railway company in the penal sum of three hundred thousand dollars and its mortgage collateral to said bond, both to secure the said traffic contract. The several instruments hereinbefore recited affect the premises hereby demised, and this lease is made and accepted subject to the provisions of the said instruments.

And the lessee further covenants that during the term of this lease all iron ore at any time removed from said premises, by whom-

soever removed, shall be removed over the lines of the said Duluth, Missabe & Northern Railway Company to the waters of Lake Superior in as nearly equal monthly quantities as may be reasonably practicable during the shipping season at the then current, open, public rates established by the railway companies for the carrying of iron ore from the Missabe range to Lake Superior ports, and not greater than the rate of eighty cents per gross ton, payable in United States gold coin; and that in view of the fact that if this lease were not made, a reduction below eighty cents gold per ton in the said current, open, public rates for carrying ore would enure to the benefit of the lessor, the royalty payable hereunder by the lessee to the lessor for each gross ton actually carried by said railway company at such lesser rate shall be increased by the amount of such reduction on each gross ton.

By "open, public rates" is meant the rates at which the ores of a consumer or consumers who do not themselves substantially control a railway from the Missabe range to Lake Superior ports are actually carried.

In consideration of the foregoing agreements and in order to secure the advantage of increased royalty in case of decreased rail rates the lessor covenants that if during the term of this lease, while such lower rail rate shall be current, as above stated, any actual competitive consumer of iron ore mined upon the Missabe range shall in fact acquire such ores at Lake Superior ports cheaper than the cost to the lessee at such ports of the ores mined by the lessee upon the demised premises, and such difference in cheapness shall
43 be due to such reduction in rail rates, the lessor will pay, ton for ton, to the lessee a sum equal to the gain per ton accruing to such consumer as against the lessee by virtue of such cheaper rail rate on every ton of iron ore mined on the Missabe range consumed by such competitor up to the total amount of the lessee's production from the demised premises during the currency of such lower rail rates.

In ascertaining the amounts to be paid under the above guaranty the lessee must satisfactorily show that any alleged advantage of a competitive consumer does not arise from a cheaper royalty than a royalty of thirty cents per ton, or cheaper cost of mining or operating—only so much of the advantage in the cost of the ore at Lake Superior ports as arises exclusively from cheaper rail rates shall be claimed or allowed hereunder. In making computations hereunder, iron ore of a competitive consumer, taken from lands owned in fee, shall be deemed to cost as much for royalty as ore on which a royalty of thirty cents per gross ton has been paid. By "consumer" is meant one who smelts ore into pig, or a corporation, an actual miner of ore on the Missabe Range, which is substantially owned and controlled by one or more who smelt ore into pig and substantially all of whose output is smelted by them.

Twelfth. Said Biwabik Mountain Iron Company heretofore granted to Peter L. Kimberly a lease of said lands for a term expir-

ing January 1st, 1903, which lease is dated April 23rd, 1892, and is recorded in the office of the register of deeds of St. Louis County, Minnesota, in Book N of agreements, at page 187, et seq.

The lessee represents that by virtue of sundry transfers and assignments it has succeeded to all the rights and estate of said Kimberly under said lease of April 23rd, 1892, and on the faith of such representation it is therefore mutually agreed and understood between the parties to this agreement that this lease and contract supersedes and supplants said former lease to P. L. Kimberly, and the same is by mutual consent hereby cancelled as of the date when this lease takes effect and solely as to time then future.

Thirteenth. The covenants, terms, and conditions of this lease shall run with the land, and be in all respects binding and operative upon the subleases and grantees under said lessee.

44 In testimony whereof, the above-named parties have caused their respective corporate names and seals to be subscribed and affixed to duplicates hereof, the day and year first above written.

BIWABIK MOUNTAIN IRON COMPANY,
By WILLIAM J. OLCOTT, *Pres.*

Biwabik Mountain Iron Co.,
Corporate seal.
Attest: E. V. CANY, *Asst. Secy.*
Witnessed as to—
Biwabik Mountain Iron Company,
By GEO. D. SWIFT,
JOSEPH B. COTTON,
GEO. WELWOOD MURRAY,
LUCIUS A. WILSON.
Biwabik Bessemer Company,
By A. M. BYERS, *President.*
Biwabik Bessemer Company,
Corporate seal.
Attest: HENRY B. SHIELDS, *Secretary.*
Witnessed as to Biwabik Bessemer Company,
By CHAS. F. RANKIN,
C. D. HINE,
W. C. CARMAN.

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EXHIBIT "D."

No. 9027 filed June 27th, 1898, at 8.33 a. m., in Book "P" of agreements, on page 637.

Biwabik Bessemer Co. to Biwabik Mining Co. Assignment of lease.

*Know all men by these presents:*

That the Biwabik Bessemer Company, a corporation organized under the laws of the State of Minnesota, in consideration of the sum

of six hundred and twelve thousand dollars received, to its full satisfaction from the Biwabik Mining Company, a corporation organized under the laws of the State of West Virginia, does hereby grant, bargain, sell, and convey unto said Biwabik Mining Company, its successors and assigns forever, all that certain leasehold estate
45 which was granted to said Biwabik Bessemer Company by the Biwabik Mountain Iron Company, by a certain written lease, bearing date of April 4th, 1898, and which written lease has been filed for record in the office of the register of deeds of St. Louis County, Minnesota. The leasehold estate, so as aforesaid granted by said Biwabik Mountain Iron Company to said Biwabik Bessemer Company, covers the following described real estate, to wit:

"Situated in the county of St. Louis, State of Minnesota, and described as follows: The northeast quarter of the northeast quarter (sometimes designated as lot one) and the southeast quarter of the northeast quarter of section three, and the northwest quarter of the northwest quarter (sometimes designated as lot four) of section two, township fifty-eight north, of range sixteen west."

And said Biwabik Bessemer Company hereby grants, bargains, sells, and conveys unto said Biwabik Mining Company all of the right, title, and interest now held by said Biwabik Bessemer Company in the above-described real estate.

Said Biwabik Bessemer Company also hereby sells and assigns unto said Biwabik Mining Company, all of the machinery, tools, supplies, and appliances of said Biwabik Bessemer Company, and all property of every kind and description now owned by it, except its claim against the estate of John Fitzgerald and except its interest in the stock of the Atlantic Iron & Steel Company, and also its bills and accounts receivable for ores sold prior to the present season.

In testimony whereof, the above-named Biwabik Bessemer Company has caused this instrument to be subscribed by its vice president, and has caused its corporate seal to be hereunto affixed and attested by its secretary on this 23rd day of June, 1898.

BIWABIK BESSEMER COMPANY,
By TOD FORD, *Vice President.*

Signed, sealed, and delivered in our presence.

MAMIE E. REESE.
C. D. HINE.

Attest:

HENRY B. SHIELDS,
*Secretary.*

Biwabik Bessemer Company,
Corporate seal.

46 EXHIBIT "E."

*Regulations No. 31, December 3, 1909.*

ARTICLE 8.

For statistical purposes, all such corporations, joint-stock companies, and associations will be classified as follows:

* * * * * * *

Class C. Industrial and manufacturing.—Such as mining, lumber, and coke companies; rolling mills; foundry and machine shops; * * *

ARTICLE 2.—Gross income.

The following definitions and rules are given for determining the gross income of the various classes of corporations:

* * * * * * *

Sale of capital assets: In ascertaining income derived from the sale of capital assets, if the assets were acquired subsequent to January 1, 1909, the difference between the selling price and the buying price shall constitute an item of gross income to be added to or subtracted from gross income according to whether the selling price was greater or less than the buying price. If the capital assets were acquired prior to January 1, 1909, the amount of increment or depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909, and which proportion shall be deducted from or added to the gross income for the year in which the sale was made. But for the purpose of determining the selling price, as provided in this section, there shall be added to the price actually realized on sale any amount which has already been set aside and deducted from gross income by way of depreciation as defined in article 4 and has not been paid out in making good such depreciation on the property sold.

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*Treasury Decision No. 1606, March 29, 1910.*

DEPRECIATION.

72. Depreciation in value of mines by the removal of ore, if not otherwise ascertainable, may be prorated as in the case of sales of capital assets.

73. Depreciation in value of mines by the removal of ore, if in excess of 5 per cent of investment, to be explained in return rendered.

47 75. Corporations leasing mines and paying royalties on ore mined not entitled to deduction for depreciation. But cor-

porations owning mines are entitled to allowance for depreciation based on fair estimate, etc.

76. Removal of timber from timber lands, while depleting the lands to the extent of such removal, is regarded as a change in the form of assets and not a depreciation within the meaning of the act.

77. Deduction on account of depreciation of property must be based on lifetime of property, its cost, value and use.

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*Treasury Decision 1675, February 14, 1911.*

DEPRECIATION IN MINERALS, OILS, ETC.

83. In case of corporations whose business consists in part or wholly of mining, producing, and disposing of deposits of nature (ores, coals, gas, petroleum, and sundry minerals) the conduct of such business will be understood to comprehend two classes of gains or losses, viz:

(a) The gain or loss resulting from the sale of capital assets, i. e., either the increment, or the loss, arising through possessing over a period of time the investment in the same.

(b) The trading or commercial gain attached to the conduct of the industry, the employment of working capital, the effort and risk involved.

84. In the ascertainment of net income deduction will be allowed for depreciation arising from exhaustion of deposits of ore, mineral, etc., and for depreciation and obsolescence of improvements, in accordance with general regulations respecting depreciation allowances, on the basis of the original capital investment cost of the properties concerned to the company reporting.

85. A further deduction will also be allowed, through not including the same at all in the item of gross income (item 3, Form 637), for the unearned increment represented in such properties as at January 1, 1909, which will be determined in general as follows:

86. An estimate should be made as of January 1, 1909, of the fair market value at that date of the minerals, etc., in deposit. This estimate should be formed on the basis of the disposal value of the minerals in total and exclusive of value of improvements and development work. This valuation should also be reduced to a unit value—per ton, barrel, etc.

48 NOTE.—Values as aforesaid should not be estimated on the basis of the assumed salable value of the output under current operative conditions, less the actual cost of production, because, as hereinbefore stated, the selling price under such conditions comprehends a profit both for carrying the investment in minerals, improvements, and working capital, and for conducting operations in respect of production and disposal of produce. The value to be determined as stated must be on the basis of the salable value of the entire deposit

of the aggregate units of minerals considered *en bloc* if disposed of in that form. Nor must such valuation comprehend any speculative value which might attach to a sale of the minerals *en bloc*, i. e., a value which might be obtained on the ground that the future would develop a much greater reserve of mineral deposits than were believed to exist at the time estimate as of January 1, 1909, was formed. Any value of this latter character would attach obviously to such additional reserves when developed in future.

87. The unit value as of January 1, 1909, ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding, and should be used in determining the unearned increment at January 1, 1909, which may be excluded entirely from the item of gross income, as before explained, in following manner, viz.:

Value at January 1, 1909, determined in manner outlined, of minerals, etc., which may be removed and disposed of in any year subsequent thereto ..... $.....

Less the following:

(a) Proportion of depreciation charge applying to exhaustion of minerals disposed of, ascertained as first explained herein on basis of original cost ..... $.....

(b) Royalty paid, if any, on minerals disposed of ..... .....

Balance, being unearned increment at January 1, 1909, to be excluded from gross income item ..... .....

49 88. The precise detailed manner in which the estimate of value of minerals, etc., as at January 1, 1909, shall be formed must naturally be determined upon by each corporation interested, but formal record of such estimates, together with all sustaining information, should be carefully filed so as to be readily accessible for reference. Values as stated, as determined at January 1, 1909, should be used in compilation in all subsequent years' excise-tax returns. The question as to whether it subsequently develops the property possessed a greater quantity of mineral, etc., reserve than was in the aggregate estimated as of January 1, 1909, is immaterial. Any excess which may be developed will be considered as possessing the same value at January 1, 1909, as that which then may have been known to be in the property.

89. Each excise-tax return (Form 637) should be accompanied with memorandum setting forth the extent in amount of the exclusion made from the item gross income for unearned increment realized during the year, as above outlined.

90. As the amount to be deducted for depreciation (paragraph 2 preceding) is to be formed on basis of the estimated reserve of minerals, etc., it follows that if it develops such estimate is understated the cost investment in the capital asset may be wholly extinguished

before all mineral reserves are removed. When this is reached, further deductions for exhaustion of minerals should be discontinued, but in such event it will be noted the allowance for unearned increment which is to be excluded entirely from gross income will be correspondingly increased.

91. In case of corporations leasing mines and paying royalties on minerals, etc., removed the royalties paid are to be treated as expenses and deducted in ascertaining net income, as provided in general regulations. Any leasehold investment which the operating corporation may have in such properties, either through a payment originally made for acquirement thereof or for improvements made upon the property, to be accounted for in accordance with regulations governing depreciation allowances and disposition of capital assets.

92. In respect to properties of the character in question which may be acquired by a corporation after January 1, 1909, a deduction will be allowed only as to depreciation arising from exhaustion based on original cost; no exclusion from gross income can be made for unearned increment, as profit arising in sale of such capital assets applies wholly to the period subsequent to January 1, 1909.

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*Treasury Decision No. 1742, December 15, 1911.*

DEPRECIATION IN COALS, MINERALS, ETC.

96. In case of corporations whose business consists in part or wholly of mining, producing, and disposing of deposits of nature (ores, coals, and sundry minerals) the conduct of such business will be understood to comprehend two classes of gains or losses, viz:

(a) The gain or loss resulting from the sale of capital assets, i. e., either the increment or the loss arising through possessing over a period of time the investment in the same.

(b) The trading or commercial gain attached to the conduct of the industry, the employment of working capital, the effort and risk involved.

97. In the ascertainment of net income deduction will be allowed for depreciation arising from exhaustion of deposits of ore, mineral, etc., and for depreciation and obsolescence of improvements, in accordance with general regulations respecting depreciation allowances, on the basis of the original capital investment cost of the properties concerned to the company reporting.

98. A further deduction will also be allowed through not including the same at all in the item of gross income (item 8, Form 637) for the unearned increment represented in such properties as at January 1, 1909, which will be determined in general as follows:

99. An estimate should be made as of January 1, 1909, of the fair market value at that date of the minerals, etc., in deposit. This esti-

mate should be formed on the basis of the disposal value of the minerals in total and exclusive of value of improvements and development work. This valuation should also be reduced to a unit value—per ton, pound, etc.

NOTE.—Values, as aforesaid, should not be estimated on the basis of the assumed salable value of the output under current operative conditions, less the actual cost of production, because, as hereinbefore stated, the selling price under such conditions comprehends a profit both for carrying the investment in minerals, improvements, and working capital, and for conducting operations in respect of production and disposal of product. The value to be determined as
51 stated must be on the basis of the salable value of the entire deposit of the aggregate units of minerals considered en bloc if disposed of in that form. Nor must such valuation comprehend any speculative value which might attach to a sale of the minerals en bloc, i. e., a value which might be obtained on the ground that the future would develop a much greater reserve of mineral deposits than were believed to exist at the time estimate as of January 1, 1909, was formed. Any value of this latter character would attach obviously to such additional reserves when developed in future.

100. The unit value as of January 1, 1909, ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding and should be used in determining the unearned increment at January 1, 1909, which may be excluded entirely from the item of gross income, as before explained, in the following manner, viz:

| | | |
|---|---|---|
| Value at Jan. 1, 1909, determined in manner outlined, of minerals, etc., which may be removed and disposed of in any year subsequent thereto | | $------ |
| Less the following: | | |
| (a) Proportion of depreciation charge applying to exhaustion of minerals disposed of, ascertained as first explained herein on basis of original cost | $------ | |
| (b) Royalty paid, if any, on minerals disposed of | ------ | ------ |
| Balance, being unearned increment at Jan. 1, 1909, to be excluded from gross income item | | ------ |

101. The precise detailed manner in which the estimate of value of minerals, etc., as at January 1, 1909, shall be formed, must naturally be determined upon by each corporation interested, but formal record of such estimates, together with all sustaining information, should be carefully filed so as to be readily accessible for reference. Values as stated, as determined at January 1, 1909, should be used in compilation in all subsequent years' excise-tax returns. The question as to whether it subsequently develops the property possessed a greater quantity of mineral, etc., reserve than was in

52 the aggregate estimated as of January 1, 1909, is immaterial. Any excess which may be developed will be considered as possessing the same value at January 1, 1909, as that which then may have been known to be in the property.

103. Each excise-tax return (Form 637) should be accompanied with memorandum setting forth the extent in amount of the exclusion made from the item gross income for unearned increment realized during the year, as above outlined.

103. As the amount to be deducted for depreciation (paragraph 2 preceding) is to be formed on basis of the estimated reserve of minerals, etc., it follows that if it develops such estimate is understated, the cost investment in the capital asset may be wholly extinguished before all mineral reserves are removed. When this is reached, further deductions for exhaustion of minerals should be discontinued, but in such event, it will be noted, the allowance for unearned increment which is to be excluded entirely from gross income with be correspondingly increased.

104. In case of corporations leasing mines and paying royalties on minerals, etc., removed, the royalties paid are to be treated as expenses and deducted in ascertaining net income, as provided in general regulations. Any leasehold investment which the operating corporation may have in such properties, either through a payment originally made for acquirement thereof or for improvements made upon the property, to be accounted for in accordance with regulations governing depreciation allowances and disposition of capital assets.

105. In respect to properties of the character in question which may be acquired by a corporation after January 1, 1909, a deduction will be allowed only as to depreciation arising from exhaustion based on original cost; no exclusion from gross income can be made for unearned increment, as profit arising in sale of such capital assets applies wholly to the period subsequent to January 1, 1909.

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*Treasury Decision 1833, February 18, 1913.*

SPECIAL EXCISE TAX ON CORPORATIONS.

Modification of note in Item No. 99, and Items 100, 101, and 103 of T. D. 1742, relative to claims for unearned increment in returns of annual net income of mining corporations.

53 TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
*Washington, D. C., February 18, 1913.*

*To collectors of internal revenue, revenue agents, and the corporations concerned:*

There have been several inquiries as to the application of the regulations relative to an allowance for an unearned increment in the

ascertainment of net income of mining corporations for the special excise tax on corporations, which indicate that the true intent of the regulations is not understood. The fact has also developed that many corporations, in their attempt to apply the regulations, begin with a current unit valuation of the product concerned instead of the en bloc value as of January 1, 1909, as is required. The manner of entering the ascertained valuation as of record has also been neglected and misunderstood.

In order to make the requirements of this office plainer and to assist corporations in arriving at valuations, which shall not be speculative in character nor founded upon the future profits and earnings of the corporations which should belong to the period during which they are earned, and in order that no portion of income which really belongs to any particular year shall be ascribed to or allotted as the earnings of previous years, items Nos. 99, 100, 101, and 103 of T. D. No. 1742 are modified so as to read as follows:

No. 99. The note is amended so that it shall read:

NOTE.—Values, as aforesaid, should not be estimated on the basis of the assumed salable value of the output under current operative conditions, less the actual cost of production, because, as hereinbefore stated, the selling price under such conditions comprehends a profit both for carrying the investment in coals, etc., improvements and working capital, and for conducting operations in respect of production and disposal of product. The value to be determined as stated must be on the basis of the salable value en bloc of the entire deposit of minerals and mineralized property, owned, exclusive of improvement and development work, if the same were disposed of in that form.

No. 100 is amended to read:

The unit value as of January 1, 1909, ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding. The
54 amount claimed as a deduction from gross income on account of unearned increment shall be shown separately in the deductions from gross income in the return of annual net income.

No. 101 is amended to read:

The precise detailed manner in which the estimate of value of minerals, etc., as at January 1, 1909, shall be formed, must naturally be determined by each corporation interested. Every corporation claiming and making a deduction for unearned increment as provided in section 100 preceding shall maintain an official book record of the properties owned by it in connection with which unearned increment is claimed, and which record shall show the general ledger or general balance sheet value thereof, together with the estimated amount of appreciated value in such properties in excess of general balance sheet values as of January 1, 1909, together with all evidence and information on basis of which such appreciative value was formed. This estimate must be formed on the lines and basis indicated in the "note," section 99, viz, the salable value of the entire

deposit considered en bloc. This record should also present clearly and fully the transactions during each year in respect of quantities of minerals disposed of and for which deductions are made respectively for depreciation and unearned increment, together with the amount thereof. No deduction for unearned increment will be allowed unless the aforesaid record is kept nor unless the evidence as to the estimates of quantity of minerals in deposit and the valuation thereof are accepted by the department. Values determined and recorded as of January 1, 1909, as aforesaid, should be used in the compilation of all subsequent years' excise-tax returns.

In case it subsequently develops the property possesses a greater quantity of minerals, etc., reserve than was in the aggregate estimated as of January 1, 1909, only such an amount of aggregate value can be assigned to such excess mineral tonnage as of January 1, 1909, as it was at said date estimated by the company attached to the property and was not assigned by it, as hereinbefore provided, to the specified tonnage in the property.

No. 108 is amended to read:

As to the amount to be deducted for depletion of deposits (Regulation No. 101) is to be formed on basis of the estimated reserve of minerals, etc., it follows that if it develops such estimate is understated the cost investment and estimated unearned increment in the capital asset may be wholly extinguished before all mineral
55 reserves are removed. When this is reached, further deductions for exhaustion of minerals should be discontinued.

Collectors of internal revenue will make requisition for the necessary number of these amendments and furnish a copy to each corporation interested.

ROYAL E. CABELL, *Commissioner.*

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EXHIBIT "F."

"Copy."

CLEVELAND, O., *March 14, 1910.*

Honorable A. N. RODWAY,
*Collector of U. S. Internal Revenue, City.*

DEAR SIR: Pursuant to the extension granted to the undersigned company we hand you herewith our income return, under the Federal corporation tax, as a mining corporation. We have been advised that we have the right to deduct from our gross income for the year the fair value of the ore in the ground on January 1, 1909, which was mined and shipped by us during the year, but we have refrained from placing any value on this ore beyond the royalty payments, partly because of the shortness of time in which we have to make the return, taking into account the difficulty of making a proper valuation, and partly because it has not been customary for us to make any valuation on our books.

Should the law be sustained as constitutional, we desire to reserve the right to amend our report in that respect, and we wish this letter to be regarded as a part of our return, in order that we may not be considered hereafter in subsequent years as waiving this question of the right to deduct the fair value of the ore mined.

We also wish at this time to formally give notice that this return, as well as any payment which may be made hereunder, is made under protest. Please acknowledge receipt.

Very truly, yours,

BIWABIK MINING COMPANY,
FRANK BILLINGS, *Sec'y.*

56 *United States internal revenue.*

RETURN OF ANNUAL NET INCOME.

(Section 38, act of Congress approved August 5, 1909.)

MANUFACTURING CORPORATIONS.

Return of net income received during the year ending December 31, 1909, by Biwabik Mining Co., a corporation, the principal place of business of which is located at Stambaugh Building, Youngstown, in the State of Ohio:

| | | |
|---|---|---|
| 1. Total amount of paid-up capital stock outstanding at close of year | | $600,000.00 |
| 2. Total amount of bonded and other indebtedness outstanding at close of year | | None. |
| 3. Gross income (see Note A) | | 1,540,946.34 |
| **Deductions.** | | |
| 4. Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation, exclusive of interest payments. (See Note B) | $1,173,431.10 | |
| 5. (a) Total amount of losses sustained January 1 to December 31 not compensated by insurance or otherwise | None. | |
| (b) Total amount of depreciation January 1 to December 31 | 11,135.24 | |
| 6. Total amount of interest paid January 1 to December 31 on an amount of bonded and other indebtedness not exceeding the amount of paid-up capital stock outstanding at the close of the year | None. | |

| | | |
|---|---|---|
| 57 7. (a) Total taxes paid January 1 to December 31 imposed under authority of the United States or any State of Territory thereof | $37,393.91 | |
| (b) Foreign taxes paid | None. | |
| 8. Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax | None. | |
| Total deductions (see Note B) | | $1,221,960.25 |
| 9. Net income | | $318,986.09 |
| 10. Specific deduction from net income allowed by law | | $5,000.00 |
| 11. Amount on which tax at 1 per centum is to be calculated for assessment | | $313,986.09 |

NOTE A.—The gross income received during the year from all sources shall in the case of a manufacturing corporation consist of the total amount ascertained through an accounting that shows the difference between the price received for the goods as sold and the cost of such goods as manufactured. The cost of goods manufactured shall be ascertained by an addition of a charge to the account of the cost of goods as manufactured during the year, of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year. To this amount should be added all items of income received during the year from other sources, including dividends received on stock of other corporations, joint-stock companies, and associations subject to this tax. In the determination of the cost of goods manufactured and sold as above such cost shall comprehend all charges for maintenance and operation of manufacturing plant, but shall not embrace allowances for depreciation or losses, which items shall be taken account of under the proper heading above as a deduction.

58 NOTE B.—The deductions authorized shall include all expense items under the various heads acknowledged as liabilities by the corporation making the return and entered on its books from January 1 to December 31. Amounts of income expended in paying dividends on stock, preferred or common, or in making permanent improvements, in betterments, etc., or in any way transferred to capital account, are not proper deductions in ascertaining annual net income. Interest paid on mortgage indebtedness on real estate acquired by a corporation may be deducted in Item 4, if the mortgage remains a lien on the property and the debt is not assumed by the corporation. The amount so paid and included in Item 4 should, however, be separately stated under Item 4.

☞ NOTE C.—This form, properly filled out and executed, must b in the hands of the Collector of Internal Revenue for the district i which is located the principal business office of the corporatio making the return on or before March 1.

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EXHIBIT "G."

*United States Internal Revenue.*

RETURN OF ANNUAL NET INCOME.

(Section 38, act of Congress approved August 5, 1909.)

MANUFACTURING CORPORATIONS.

Return of net incomes received during the year ending December 31, 1910, by Biwabik Mining Co., a corporation, the principal place of business of which is located at Stambaugh Building, Youngstown, in the State of Ohio:

| | | |
|---|---|---|
| 1. Total amount of paid-up capital stock outstanding at close of year | | $600,000.00 |
| 2. Total amount of bonded or other indebtedness outstanding at close of year | | None. |
| 3. Gross income (see Note A) | | $1,456,263.62 |

50

Deductions.

| | | |
|---|---|---|
| 4. Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation (see Note B) | $1,178,216.88 | |
| 5. (a) Total amount of losses sustained January 1 to December 31 | 28,592.46 | |
| (b) Total amount of depreciation January 1 to December 31 | | |
| Total (see Note B) | | |
| 6. Total amount of interest January 1 to December 31 on bonded or other indebtedness to an amount not to exceed amount of paid-up capital at close of year (see Note B) | | |

| | | |
|---|---|---|
| 7. (a) Total taxes paid January 1 to December 31 imposed under authority of the United States or any State or Territory thereof | 38,384.18 | |
| (b) Foreign taxes paid | | |
| Total (see Note B) | | |
| 8. Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax | | |
| Total deductions | | 1,245,195.52 |
| 9. Net income | | 211,070.10 |
| 10. Specific deduction from net income allowed by law | | 5,000.00 |
| 11. Amount on which tax at one per centum is to be calculated | | 206,070.10 |

60 The amount excluded from "Gross income" for year ending December 31, 1910, to cover realization of unearned increment was $265,362.08.

NOTE A.—The gross income received during the year from all sources shall in the case of a manufacturing corporation consist of the total amount ascertained through an accounting that shows the difference between the price received for the goods as sold and the cost of such goods as manufactured. The cost of goods manufactured shall be ascertained by an addition of a charge to the account of the cost of goods as manufactured during the year, of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year. To this amount should be added all items of income received during the year from other sources, including dividends received on stock of other corporations, joint-stock companies, and associations subject to this tax. In the determination of the cost of goods manufactured and sold as above such cost shall comprehend all charges for maintenance and operation of manufacturing plant, but shall not embrace allowances for depreciation or losses, which items shall be taken account of under the proper heading above as a deduction.

NOTE B.—The deductions authorized shall include all expense items under the various heads acknowledged as liabilities by the corporation making the return and entered as such on its books from January 1 to December 31 of the year for which return is made.

☞ NOTE C.—This form, properly filled out and executed, must be in the hands of the collector of internal revenue for the district in which is located the principal office of the corporation making the return on or before March 1.

## EXHIBIT H.

*The Biwabik Mining Company—Appraised valuation of unmined ores January 1, 1909.*

| Mines. | Estimated tonnage unmined Jan. 1, 1909. | Total appraised valuation of unmined ores Jan. 1, 1909. | Appraised valuation per ton. | Division of total valuation. | | | Memoranda. | |
|---|---|---|---|---|---|---|---|---|
| | | | | General ledger of capitalized value. | Fee owners valuation as represented by royalty, 1909. | Net increment value Jan. 1, 1909. | Rate of general ledger or capitalized value. | Rate of increment value Jan. 1, 1909. |
| Biwabik | 6,574,622 | $5,413,822.31 | $0.7875 | $267,081.90 | $2,002,408.50 | $3,084,331.91 | 0.03865 | 0.44892 |
| Cincinnati | 86,357 | 67,927.50 | .7875 | 13,111.07 | None. | 54,816.33 | .15200 | .63550 |
| Cleveland | 250,000 | 196,875.00 | .7875 | 12,807.50 | $1,280.00 | 152,727.50 | .06159 | .61091 |

| Mines. | Ore disposed of in year 1909. | | | Balance Jan. 1, 1910. | | | Ore disposed of in year 1910. | | | Balance Jan. 1, 1911. | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Tons. | This company's value attaching to same. | | Tons. | This company's value attaching to same. | | Tons. | This company's value attaching to same. | | Tons. | This company's value attaching to same. | |
| | | Capitalized value. | Net increment value. | | Capitalized value. | Net increment value. | | Capitalized value. | Net increment value. | | Capitalized value. | Net increment value. |
| Biwabik mine | 843,221 | $81,098.60 | $243,295.84 | 6,231,374 | $345,908.30 | $2,840,795.27 | 844,253 | $21,148.11 | $244,232.97 | 5,787,521 | $324,845.19 | $2,596,571.30 |
| Cincinnati mine | 4,357 | 668.63 | 2,862.36 | 81,720 | 12,431.45 | 51,953.06 | | | | 81,720 | 12,431.45 | 51,953.06 |
| Cleveland mine | | | | 250,000 | 12,807.50 | 152,727.50 | | | | 250,000 | 12,807.50 | 152,727.50 |

61 *Motion for a new trial.*

Filed May 24, 1916.

Now comes the defendant, and moves the court to set aside the decision and judgment rendered herein, and for a new trial of this cause, for the following causes affecting materially the defendant's substantial rights:

The decision and judgment herein are not sustained by but are contrary to the evidence herein, and are contrary to law.

BIWABIK MINING COMPANY,
By HOYT, DUSTIN, KELLEY, MCKEEHAN & ANDREWS,
*Its Solicitors.*

*Order overruling motion for new trial.*

Entered May 24th, 1916, by Judge Clarke.

This day this cause came on to be heard on the motion of defendant for a new trial, and was submitted to the court; on consideration thereof the court overruled said motion, to which ruling of the court defendant, by its attorneys excepts.

It is further ordered by the court that the defendant have fifty (50) days in which to prepare and file its bill of exceptions.

62 *Petition for writ of error.*

Filed May 26, 1916.

Now comes the Biwabik Mining Company, defendant herein, and says that on or about the 24th day of May, 1916, this court entered judgment herein in favor of the plaintiff and against this defendant, in which judgment and the proceedings had prior thereunto in this cause, certain errors were committed to the prejudice of this defendant, all of which will more in detail appear from the assignment of errors which is filed with this petition.

Wherefore, this defendant prays that a writ of error may issue in its behalf, out of the United States Circuit Court of Appeals for the Sixth Circuit, for the correction of errors so complained of, and that a transcript of the record, proceedings, and papers in this case duly authenticated, may be sent to the said Circuit Court of Appeals.

HOYT, DUSTIN, KELLEY, MCKEEHAN & ANDREWS,
*Attorneys for Defendant.*

The above petition for writ of error is hereby allowed this 26th day of May, 1916. Bond on writ of error is fixed at $4,000.

JOHN H. CLARKE,
*District Judge.*

63 *Assignments of error.*

Filed May 26, 1916.

The defendant in this action in connection with its petition for a writ of error makes the following assignments of error, which it avers occurred upon the trial of the cause, to wit:

1st. The judgment of the court is contrary to the evidence and is not sustained by sufficient evidence, and is contrary to law.

2nd. The court erred in finding that the defendant was entitled to deduct only the sum of .03885 cents per ton on the 544,353 tons of ore mined by it during the year 1910 in its return for said year.

3rd. The court erred in finding that the defendant was not entitled to deduct the sum of 48.75 cents per ton on the total tonnage of ore mined by it in the year 1910 in its return for said year.

4th. The court erred in finding that there was due from the defendant to the plaintiff the sum of $2,442.23, or any other sum whatsoever.

5th. The court erred in finding that the plaintiff was entitled to interest on the sum of $2,442.23 from the 30th day of June, 1911.

Wherefore, the defendant prays that said judgment may be reversed.

HOYT, DUSTIN, KELLEY, MCKERHAN & ANDREWS,
*Attorneys for Defendant.*

64 *Order allowing writ of error.*

Entered May 26th, 1916, by Judge Clarke.

This 26th day of May, 1916, came the defendant, the Biwabik Mining Company, by its attorneys, and filed herein and presented to the court its petition praying for the allowance of a writ of error and assignments of error, intended to be urged by it, praying also that a transcript of the record, proceedings, and papers upon which the judgment herein was rendered, duly authenticated, may be sent to the United States Circuit Court of Appeals for the Sixth Judicial Circuit and that such other and further proceedings may be had as may be proper in the premises.

On consideration whereof the court does allow the writ of error upon the defendant giving bond, according to law, in the sum of $4,000.00.

*Bond on writ of error.*

Filed May 27, 1916.

Know all men by these presents, that we, Biwabik Mining Company, as principal and Frank Billings as sureties, are held and firmly bound unto the United States of America in the full and just sum of $4,000.00 to be paid to the said United States of America, its certain attorneys, successors, or assigns, to which payment well and truly to be made, we bind ourselves, our heirs, executors, administrators, and successors, jointly and severally, by these presents. Sealed with our

seals and dated this 27th day of May in the year of our Lord one thousand nine hundred and sixteen.

Whereas lately at a session of the United States District Court for the Northern District of Ohio, Eastern Division, in a suit pending in said court between the United States of America, plaintiff,
65 and Biwabik Mining Company, defendant, a judgment was rendered against the said Biwabik Mining Company and the said Biwabik Mining Company having obtained a writ of error and filed a copy thereof in the clerk's office of the said court to reverse the judgment in the aforesaid suit, and a citation directed to the United States of America citing and admonishing it to be and appear at a session of the United States Circuit Court of Appeals for the Sixth Circuit to be holden at the city of Cincinnati, in said circuit, on the ____ day of _____ next.

Now, the condition of the above obligation is such that if the said Biwabik Mining Company shall prosecute said writ of error to effect, and answer all damages and costs of it fail to make its plea good, then the above obligation to be void; else to remain in full force and virtue.

BIWABIK MINING COMPANY,
By FRANK BILLINGS, *Sec'y.* [SEAL.]
FRANK BILLINGS.

Approved May 27, 1916:
JOHN H. CLARKE.

67 *Citation.*

United States Circuit Court of Appeals for the Sixth Circuit.

UNITED STATES OF AMERICA,
*Sixth Judicial Circuit, ss:*

*To the United States of America, greeting:*

You are hereby cited and admonished to be and appear at a session of the United States Circuit Court of Appeals for the Sixth Circuit, to be holden at the city of Cincinnati, in said circuit, on the * 28th day of June next, pursuant to a writ of error filed in the clerk's office of the District Court of the United States for the Northern District of Ohio, wherein the Biwabik Mining Company is plaintiff in error and you are defendant in error, to show cause, if any there be, why the judgment rendered against the said plaintiff in error as in the said petition for writ of error mentioned should not be corrected and why speedy justice should not be done to the parties in that behalf.

Witness the Honorable Edward D. White, Chief Justice of the United States, this 29th day of May, in the year of our Lord one thousand nine hundred and sixteen and of the independence of the United States of America the one hundred and fortieth.

JOHN H. CLARKE,
*Judge of the District Court.*

* Not exceeding 30 days from day of signing.

Service of the above citation is hereby acknowledged and appearance of defendant in error is hereby entered.

F. B. KAVANAGH,
*Asst. United States Attorney.*

MAY 29th, 1916.

69 *Writ of error.*

United States Circuit Court of Appeals for the Sixth Circuit.

UNITED STATES OF AMERICA,
*Sixth Judicial Circuit, ss:*

*The President of the United States to the honorable the judge of the District Court of the United States for the Northern District of Ohio, greeting:*

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said District Court, before you, or some of you, between the United States of America as plaintiff and the Biwabik Mining Company as defendant, a manifest error hath happened, to the great damage of the said the Biwabik Mining Company, as by its complaint appears. We being willing that error, of any hath been, should be duly corrected and full and speedy justice done to the parties aforesaid in this behalf, do command you, if the judgment be therein given, that then under your seal, distinctly and openly, yon send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Sixth Circuit, together with this writ, so that you have the same at Cincinnati, in said circuit, on the * 28th day of June next, in the said Circuit Court of Appeals, to be then and there held, that the record and proceedings aforesaid being inspected, the said Circuit Court of Appeals may cause further to be done therein to correct that error what of right and according to the laws and customs of the United States should be done.

Witness the Honorable Edward D. White, Chief Justice of the United States, the 29th day of May, in the year of our Lord one thousand nine hundred and sixteen and of the independence of the United States of America the one hundred and fortieth.

[SEAL.] B. C. MILLER,
*Clerk of the District Court of the United States for the Northern District of Ohio.*
By R. C. DEAN, *Deputy.*

Allowed by—
JOHN H. CLARKE,
*Judge of the District Court.*

* Not exceeding 30 days from the day of signing the citation.

70 *Return on writ of error.*

UNITED STATES OF AMERICA,
*Northern District of Ohio, ss:*

In pursuance to the command of the within writ of error, I, B. C. Miller, clerk of the United States District Court within and for said district, do herewith transmit under the seal of said court a full, true, and complete copy of the record and proceedings of said court in the cause and matter in said writ of error stated, together with all things concerning the same, in accordance with the precipe filed, to the United States Circuit Court of Appeals for the Sixth Circuit.

There is annexed hereto and made part of this return the writ of error and citation to said defendant in error.

Witness my official signature and the seal of said court at Cleveland, in said district, this 24th day of June, A. D. 1916, and in the 140th year of the independence of the United States of America.

[SEAL.] B. C. MILLER, *Clerk.*
By R. C. DEAN, *Deputy Clerk.*

Filed June 24th, B. C. Miller, clerk U. S. District Court, Northern District of Ohio.

71 *Praecipe for transcript.*

Filed May 27, 1916.

*To the clerk:*

Please prepare transcript of record for the Circuit Court of Appeals in the above entitled cause, and include therein the following papers and orders:

1. Petition filed October 7, 1915.
2. Answer filed November 30, 1915.
3. Reply filed February 8, 1916.
4. Statement as to agreed facts filed February 3, 1916, is attached to final judgment as Exhibit A, and said agreed statement of facts will be found at pages 23 to 60 of this record.
5. Waiver of jury and consent to submit to court on agreed statement of facts filed February 11, 1916.
6. Bill of exceptions filed May 26, 1916.
7. Memorandum opinion of court filed May 17, 1916.
8. Final judgment for plaintiff entered May 24, 1916.
9. Motion for a new trial filed May 24, 1916.
10. Order overruling motion for a new trial filed May 24, 1916.
11. Petition for writ of error filed May 26, 1916.
12. Assignments of error filed May 26, 1916.
13. Order allowing writ of error entered May 26, 1916.
14. Bond filed May 27th, 1916.
15. Citation filed May 29th, 1916.

16. Writ of error and return filed May 29th, 1916.
17. This precipe filed May 27th, 1916.

And deliver all papers to the Gates Legal Publishing Company for printing.

HOYT, DUSTIN, KELLEY, MCKEEHAN & ANDREWS,
*Attorneys for Defendant.*

73 *Certificate of clerk.*

NORTHERN DISTRICT OF OHIO, *ss:*

I, B. C. Miller, clerk of the District Court of the United States for said district, do hereby certify that the annexed and foregoing pages contain a full, true, and complete copy of the final record, including the bill of exceptions, petition for writ of error, assignment of errors, and all proceedings in said cause in accordance with the precipe for transcript filed by plaintiff in error.

There is also annexed to and transmitted with such record, the writ of error and citation issued and allowed in this case.

In testimony whereof I have hereunto signed my name and affixed the seal of said court at Cleveland in said district, this 24th day of June, A. D. 1916, and in the 140th year of the Independence of the United States of America.

[SEAL.]

B. C. MILLER, *Clerk.*
By R. C. DEAN, *Deputy Clerk.*

75 Proceedings in the United States Circuit Court of Appeals for the Sixth Circuit.

*Appearance of counsel.*

(Filed June 28, 1916.)

WILLIAM C. COCHRAN, *Clerk of Said Court:*

Please enter my appearance as counsel for the plaintiff in error.

A. C. DUSTIN,
HOYT, DUSTIN, KELLEY, MCKEEHAN & ANDREWS,
*Cleveland, Ohio.*

*Cause argued and submitted.*

(March 15, 1917.—Before Warrington and Denison, C. JJ., and Sater, D. J.)

This cause is argued by Mr. A. C. Dustin for the plaintiff in error and by Mr. E. S. Wertz, United States district attorney, for the defendant in error, and is submitted to the court.

76 *Opinion.*

(Filed May 8, 1917.)

77 Filed May 8, 1917. Wm. C. Cochran, Clerk.

No. 2938.

United States Circuit Court of Appeals, Sixth Circuit.

| | |
|---|---|
| BIWABIK MINING COMPANY, plaintiff in error, *vs.* THE UNITED STATES OF AMERICA, defendant in error. | Error from the District Court of the United States for the Northern District of Ohio, Eastern Division. |

Submitted March 15, 1917.—Decided May 8, 1917.

Before Warrington and Denison, circuit judges, and Sater, district judge.

The Biwabik Company is an operating iron mining company. In 1910 the company made its return to the collector of internal revenue for the year 1910 as required by the excise-tax law of August 5, 1909 (36 St., p. 112, §38), and paid the tax indicated by the return. In 1915 the United States brought this action, alleging that the return for the year 1910 wrongfully omitted from income the sum of $265,372, and asking a judgment for one per cent, of this amount. Judgment for the United States was rendered in the court below, and the company assigns error. The case was submitted to the district judge without a jury upon an agreed statement of facts, and presents only questions of law.

The company was lessee of the property, on which it was operating, under a mining lease and under a method of business which
78 has become familiar to us through many cases which have come to this court. In these contracts the lessee is privileged to remove ore upon the payment of a certain price per ton, called "royalty." The leases run for long periods of years (in this case 50 years), and they contain many provisions for regulating the rights of the parties. The royalty is usually fixed for the whole period at some standard rate per ton, and if the market conditions at the time indicate a higher value for the ore in the ground than the standard royalty, the lessee pays at the time of taking the lease a bonus in cash designed to meet so much of this advanced value as is thought to be sufficiently permanent. When the lessee sells to another operator his interest in the lease, the price is determined by fixing the bonus to be paid, and thereupon the purchaser steps into the position of the first lessee.

In 1898 the owner of certain iron ore lands upon the Mesaba Range, in Minnesota, executed a mining lease of this character. The lessee's rights thereunder, after some mesne transfers, were duly purchased by the Biwabik Mining Company in June, 1898, in consideration of $612,000 cash. This consideration also covered certain other personal property of the assignor. From 1898 to and including 1910 the Biwabik carried on the operation, paying to the lessor the prescribed royalty of 30c per ton.

It is also familiar that the iron ore deposits of the Mesaba Range are of a different character from those in (most) other iron-mining districts. The ore is not found in veins which incline more or less vertically, and which are of constantly changing thickness, shape, and quality, as is typically the case with the precious metals; nor does it lie as coal does, in comparatively thin veins, approaching the horizontal. It lies in horizontal bodies, lenticular in form, comparatively near the surface, and the body of the ore, except at the edges of the deposit, is of a very considerable thickness. It is soft, and it is mined by stripping off and carrying away the overlying surface and then excavating the ore with steam shovels. Such a so-called mine is in truth nothing more nor less than a quarry. The quality of the ore throughout such a deposit is substantially constant, and the quantity, by the use of diamond drills upon the surface and by simpler methods after it has been stripped, can be measured
79 with substantial accuracy. This general situation has been applied to this case by the stipulation of the parties, as follows:

4. The iron ore body on said property lies in a flat or blanket formation from about thirty to sixty feet below the surface, and the ore is mined by steam shovels after the removal of the surface. The boundaries of said ore body and the depth, quantity, and quality of said ore is capable of determination with extraordinary accuracy by test pits, shafts, and drilling from the surface. Prior to the year 1900 there had been mined and removed from said premises 7,420,114 tons of iron ore, and in connection therewith, by drilling and by standard recognized methods, defendant had calculated the tonnage and the quality of the iron ore then still remaining upon the said premises, and had ascertained that said property contained 6,874,695 tons of merchantable iron ore, all of which was readily and easily minable and removable before the expiration of the date of said contracts, in the year 1948.

5. In the condition said premises were in on January 1, 1900, the contract of April 4, 1866, and the rights created thereby, exclusive of buildings and machinery on said premises, were of the actual value of $3,351,413.81, and the ore in said property, considering the entire deposit thereof en bloc, on January 1, 1900, was of the value of 48½c. per ton, exclusive of the royalty of 30c per ton provided for in the lease.

During the year 1910, the company mined and shipped, or otherwise disposed of, 544,353 tons of such ore at an average sale price of $3.10 per ton. Of this price, 30c. represented the royalty, about $1.90 the operating and similar costs, 4c. the original bonus paid to the assignor of the lease (plus interest and taxes), 44½¢ the additional value which, according to the stipulation, the interest of the

company was worth January 1, 1909, and about 40¢, the company's net profit over and above these items.

Shortly after the excise-tax law was passed, the Commissioner of Internal Revenue, who was by law charged with that duty, promulgated regulations governing its collection. The presently material parts of such regulations, as first promulgated and as later modified, are as follows:

REGULATION No. 31, ISSUED DECEMBER 3, 1909.

*Article 2, gross income.*

The following definitions and rules are given for determining the gross income of the various classes of corporations:

* * * * * * *

Sale of capital assets.—In ascertaining income derived from the sale of capital assets, if the assets were acquired subsequent to January 1, 1909, the difference between the selling price and the buying price shall constitute an item of gross income to be added to or subtracted from gross income according to whether the selling price was greater or less than the buying price. If the capital assets were acquired prior to January 1, 1909, the amount of income or depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909, and which proportion shall be deducted from or added to the gross income for the year in which the sale was made. But for the purpose of determining the selling price, as provided in this section, there shall be added to the price actually realized on sale any amount which has already been set aside and deducted from gross income by way of depreciation as defined in article 4 and has not been paid out in making good such depreciation on the property sold.

REGULATIONS 72–77, ISSUED MARCH 29, 1910, BY TREASURY DECISION No. 1606.

*Depreciation.*

72. Depreciation in value of mines by the removal of ore, if not otherwise ascertainable, may be prorated as in the case of sales of capital assets.

73. Depreciation in value of mines by the removal of ore, if in excess of 5 per cent of investment, to be explained in return rendered.

75. Corporations leasing mines and paying royalties on one mined not entitled to deduction for depreciation. But corporations owning mines are entitled to allowance for depreciation based on fair estimate, etc.

76. Removal of timber from timber lands, while depleting the lands to the extent of such removal, is regarded as a change in the form of assets and not a depreciation within the meaning of the act.

77. Deduction on account of depreciation of property must be based on lifetime of property, its cost, value, and use.

REGULATIONS 33–92, ISSUED FEBRUARY 14, 1911, BY TREASURY DECISION No. 1675.

*Depreciation in minerals, oil, etc.*

82. In case of corporations whose business consists in part or wholly of mining, producing, and disposing of deposits of nature (ores, coals, gas, petroleum, and sundry minerals) the conduct of such business will be understood to comprehend two classes of gains or losses, viz:

(a) The gain or loss resulting from the sale of capital assets, i. e., either the increment, or the loss, arising through possessing over a period of time the investment in the same.

(b) The trading or commercial gain attached to the conduct of the industry, the employment of working capital, the effort and risk involved.

84. In the ascertainment of net income, deduction will be allowed for depreciation arising from exhaustion of deposits of ore, mineral, etc., and for depreciation and obsolescence of improvements in accordance with general regulations respecting depreciation allowances, on the basis of the original capital investment cost of the properties concerned to the company reporting.

81 85. A further deduction will also be allowed, through not including the same at all in the item of gross income (item 3, Form 637), for the unearned increment represented in such properties as at January 1, 1909, which will be determined in general as follows:

86. An estimate should be made as of January 1, 1909, of the fair market value at that date of the minerals, etc., in deposit. This estimate should be formed on the basis of the disposal value of the minerals in total and exclusive of value of improvements and development work. This valuation should also be reduced to a unit value—per ton, barrel, etc.

87. The unit value as of January 1, 1909, ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding, and should be used in determining the unearned increment at January 1, 1909, which may be excluded entirely from the item of gross income, as before explained, in following manner, viz:

| | | |
|---|---|---|
| Value at January 1, 1910, determined in manner outlined, of minerals, etc., which may be removed and disposed of in any year subsequent thereto | | $ |
| Less the following: | | |
| (a) Proportion of depreciation charge applying to exhaustion of minerals disposed of, ascertained as first explained herein on basis of original cost | $ | |
| (b) Royalty paid, if any, on minerals disposed of | $ | $ |
| Balance, being unearned increment at January 1, 1909, to be excluded from gross income item | $ | $ |

88. The precise detailed manner in which the estimate of value of minerals, etc., as at January 1, 1909, shall be formed, must naturally be determined upon by each corporation interested, but formal record of such estimates, together with all sustaining information shall be carefully filed so as to be readily accessible for reference. Values as stated, as determined at January 1, 1909, should be used in compilation in all subsequent years' excise-tax returns. The question as to whether it subsequently develops the property possessed a greater quantity of mineral, etc., reserve than was in the aggregate estimated as of

January 1, 1909, is immaterial. Any excess which may be developed will be considered as possessing the same value at January 1, 1909, as that which then may have been known to be in the property.

NOTE.—Values as aforesaid should not be estimated on the basis of the assumed salable value of the output under current operative conditions, less the actual cost of production, because as hereinbefore stated the selling price under such conditions comprehends a profit both for carrying the investment in minerals, improvements, and working capital, and for conducting operations in respect of production and disposal of product. The value to be determined as stated must be on the basis of the salable value of the entire deposit of the aggregate units of minerals considered en bloc if disposed of in that form. Nor must such valuation comprehend any speculative value which might attach to a sale of the minerals en bloc, i. e., a value which might be obtained on the ground that the future would develop a much greater reserve of mineral deposits than were believed to exist at the time estimate as of January 1, 1909, was formed. Any value of this latter character would attach obviously to such additional reserves when developed in future.

82 89. Each excise-tax return (Form 637) should be accompanied with memorandum setting forth the extent in amount of the exclusion made from the item gross income for unearned increment realized during the year, as above outlined.

90. As the amount to be deducted for depreciation (paragraph 2 preceding) is to be formed on basis of the estimated reserve of minerals, etc., it follows that, if it develops such estimate is understated, the cost investment in the capital asset may be wholly extinguished before all mineral reserves are removed. When this is reached further deductions for exhaustion of minerals should be discontinued, but in such event, it will be noted, the allowance for unearned increment which is to be excluded entirely from gross income will be correspondingly increased.

91. In case of corporations leasing mines and paying royalties on minerals, etc., removed, the royalties paid are to be treated as expenses and deducted in ascertaining net income, as provided in general regulations. Any leasehold investment which the operating corporation may have in such properties, either through a payment originally made for acquirement thereof or for improvements made upon the property, to be accounted for in accordance with regulations governing depreciation allowances and disposition of capital assets.

92. In respect to properties of the character in question which may be acquired by a corporation after January 1, 1909, a deduction will be allowed only as to depreciation arising from exhaustion basis on original cost; no exclusion from gross income can be made for unearned increment, as profit arising in sale of such capital assets applies wholly to the period subsequent to January 1, 1909."

These regulations of February, 1911, were again promulgated without material change in December, 1911, as Nos. 96–105, and remained in force without change until February, 1913, at which date original Nos. 86, 87, 88, and 90 were slightly amended.

In compliance with these regulations, the Biwabik Company made the estimates required and entered upon a suitable record book the following:

January 1, 1909.

| | |
|---|---|
| Estimated tonnage unmined | 6,874,695 |
| Total appraised valuation of unmined ores | $5,413,822 |
| Appraised valuation per ton | .7875 |

| | |
|---|---|
| General ledger or capitalized value | $267,081 |
| Fee owner's valuation as represented by royalty | $2,062,408 |
| Net increment value | $3,084,331 |
| Rate of general ledger or capitalized value | .03885 |
| Rate of increment value | .44965 |

It thereafter maintained such book for each year, the entries for 1910 being as follows:

| | |
|---|---|
| Tonnage unmined January 1, 1910 | 6,331,874 |
| This company's capitalized value | $245,993 |
| This company's net increment value | $2,840,795 |
| Tons disposed of during the year 1910 | 544,353 |
| Capitalized value thereof | $21,143 |
| Net increment value thereof | $244,223 |
| Tonnage unmined January 1, 1911 | 5,787,521 |

83 When the company made its return for 1910, it deducted from its annual receipts for the sale of ore the total of this capitalized value and this increment value, being $265,372, treating these two items as being not income but the selling price of capital assets, and entered the remainder as its gross income. From this gross income, it made the deductions permitted by statute, thus arriving at the net income upon which it computed and paid one per cent tax. Upon these facts the district court was of the opinion that the capitalized value could rightfully be deducted before stating gross income, but that the increment value could not, and, accordingly, judgment was rendered for one per cent computed upon the item of $244,223.

DENISON, Circuit Judge (after stating the facts as above):

The proper application of this statute, to facts more or less analogous to those now involved, has recently been considered by the Supreme Court in a line of cases of which the Sargeant Land Company case (January 15, 1917) is the latest, and by this court in Doyle *v.* Mitchell (235 Fed., 686) and in Cleveland Ry. Co. *v.* United States, this day decided. The facts of the present case differ considerably from any of the others, and the inquiry must be whether the principle of decision involved in these cases may control or indicate the result to be reached here.

This statute measures taxation by net income. It declares the net income to be what is left after certain deductions from gross income. Obviously, we can make no headway in applying this measure until we define "gross income," and it is equally sure we can only learn what "gross income" is by first defining "income."

It is urged that we are not concerned with the meaning of "income," because under this statute income is not the thing taxed, but is the measure of taxation. We do not appreciate the force of the claimed inference. Income is a word capable of definition. Of course, its definition may cover a variety of specific meanings, and its context may determine which specific meaning should be accepted; but no reason has been suggested, and none occurs to us, why the mere fact that the term is used as a yardstick for measuring taxation or something else, rather than as describing the thing
84 upon which the tax rests, should indicate that one or another specific meaning is the right one. It is well known that Con-

gress was driven to tax the privilege (according to its value as indicated by its net income) because of the failure of the law taxing "income" directly; and, to say the least, there can be no presumption that between the old law and the new one Congress had changed its idea of what the word "income" meant. When reduced to final terms, to say that "income" in this law does not mean generally the same thing as it does in income-tax laws is to say that levying upon the income of a company a tax of one per cent will produce ten dollars, while levying upon the franchise of that company a tax of one per cent of its income may produce twelve dollars; and we can not approve that proposition.

It would have been perfectly natural for Congress to decide that the tax which it was to impose upon the privilege should be measured either by the amount of business done thereunder or by the proved value of the privilege. Either would have been a logical basis for such taxation. If the former had been the adopted theory, the tax would have been measured by total receipts, or by total sales, or by total disbursements, or by some combination of these measurements, and any thought of profits would have been utterly foreign to the scheme of measurement. The most casual inspection of the law shows that this theory was not adopted. On the contrary, all ordinary expenses and losses in the conduct of the business were expressly to be deducted, and only the remainder was to be taxed. Whether this remainder happened to be called net income or net profits was a matter of no consequence; by either name it was the same thing. It is of the essence of the law that a corporation doing a business of $100,000 and making $50,000 profit is to be taxed one per cent upon that profit, less the exemption, or $450, while a corporation doing a business of $10,000,000 and making no profit is not to be taxed at all. It is clear to a demonstration that Congress deliberately intended to tax the franchise according to its actual value to the user as determined by the annual profit derived therefrom, without regard to its value as indicated by the amount of business done.

So, too, it is urged that we should not be concerned with this definition, because the statute itself carefully defines what the
85 tax upon income shall be. As has been pointed out, this idea rests upon a clear misapprehension of the statute; the law does not purport to do this or anything like this. The statutory computation rests upon the assumption that we already know what income is as distinguished from other matters; otherwise, it would be impossible to state that gross income which is the foundation of that statutory computation.

We therefore are confirmed in our opening statement that to rightly interpret this law we must interpret and define "income." It must, by certain attributes, be distinguished out of the mass, or from other things with which it is compared. Distinctive definitions involve contrast. Since the law specifies "income" and not "sales" or "receipts" or "capital and surplus," or any other standard of measurement which might have been named, what should be set over

against "income" to bring out this distinctive character? In every case in the Supreme Court and in the lower courts, including and since the Stratton's Independence case, it has been assumed that the receipts and accumulations of a business corporation are of two classes—one those which constituted its gross income and the other those which represented the sale or conversion of its capital; and the controversy has always been as to the respective definitions of those two classes. We accept this as the rightful criterion, not only because it has been universally accepted, but because we think it must be right. The only alternative is to say that all receipts from the conduct of a business according to its intended plan are income. To say this is to destroy the effect of carefully selected words. It would involve the conclusion that in case of a company organized to buy land and subdivide and sell lots, all receipts from the sales of lots were "gross income," even though the lots were all sold and the invested capital not realized; and that, since only disbursements made during the year can be deducted, the capital so invested in one year and realized the next year would be taxable net income. So far as words are concerned, it is impossible to say that the law did not intend to go to that very extent; but to say so would be such a departure from the administrative practice and rules which have prevailed from the beginning, and from what we think the law has always been assumed to mean that we are unwilling to take so radical a step. So we come to what we deem the decisive question, viz, "So far as the sell-
86 ing price of the ore in 1910 represented its actual value to the company in the ground on January 1st, 1909, was it income or was it the sale price of capital assets?"

In its general aspect this question is the same as that discussed in Doyle v. Mitchell. We may here refer to that opinion, without repeating it at length, for the matters there stated. Unless that case was wrongly decided, the question must be whether this case is to be distinguished in principle.

Certainly there is no great difference in the inherent character of the assets transferred and sold. The ore below the surface and the trees above were interests in realty until they were severed. Upon severance and preliminary treatment each became the raw material for further process of manufacture. The extent and quality of each before severance were determined by expert appraisal. Each before severance had a known and realizable market value. Each had been purchased in its unsevered form by the company taxed, and each, while still in that form, had increased in market value after the purchase and before the law was passed, and had then further increased before severance, and in each case the market value when the law went into effect had been ascertained and stated accurately and in good faith. What are the distinctions urged?

The first is that the company was a mining company and not a manufacturing company. The law makes no such distinction, and there can be no magic in the word "mining" as part of a corporate

name. Where a mining business is of the character described in the Stratton's Independence case it is clear enough that there is great if not insuperable difficulty in ascertaining the value of the ore in the ground at a fixed date. The whole subject may well be thought too speculative to justify attributing to "depletion of capital" any ore which had been removed. The annual operations of such a mine are expected to and often do develop new ore bodies of even greater value than those removed. Not only are the value and the extent of the ore in place unknown, but the cost of removal is highly uncertain, since it will depend upon unknown and constantly changing conditions. The same considerations apply more or less perfectly to the gas and oil operations and to the coal mining which have been considered in decided cases. These things are so typical of mining operations, as a class, that perhaps we should apply to everything belonging in that general class a general rule which will prevent an appraisal of the ore in place as a capital asset at the beginning of the period. The present case does not belong in that class. The parties have stipulated to the extent and value of the ore in the ground on January 1st, 1909. Nothing could be more definite or certain. As was said in the statement of facts, this was a quarrying operation. It involved no elements of uncertainty, except those future contingencies which affect the value of all raw materials. In spite of the name of the company, the business more nearly approximated manufacturing than it did mining, as the latter term is commonly understood.

87

It is next said that the company was not the owner, but only a lessee: indeed, the internal-revenue department made this the controlling fact, since by its rules and regulations it permitted mining companies who owned the fee of the lands in which the ore was located to treat as capital assets the value of their ore in the ground at the beginning of the year, if they were able to ascertain that value, but the department refused to extend this ruling to cases where the mining company was only a lessee. (Regulation 75, supra; but see also Regulation 91, supra.) It is difficult to appreciate the supposed distinction. This company was removing 500,000 tons per year. The deposit was six million tons. There were thirty years remaining of the period permitted for removal. The lessee's interest could be and had been bought and sold, and it had been salable for the stipulated price at the beginning of the taxing period. Counsel for the Government has not pointed out the reason for this distinction made by the department. We suppose it must lie in the thought that since the lease may be forfeited or given up before the ore is all removed the annual operations must be treated as an annual purchase from the lessor, at the royalty price, of the amount each year removed, and so all the value realized above the royalty must be income for the year. We doubt the force of this construction. It comes to saying that what would otherwise have been capital at the beginning of the year must not be so treated, because the company might have

elected or been compelled to forfeit to one who had an underlying claim, or to saying that the owner of mortgaged mining property could not consider the existing value of his equity as his capital, because if conditions changed he might lose it by foreclosure. We think that the lessee of such property and under such a lease is as much entitled as is the owner of the fee to treat the value of his interest in the ore in the ground at the beginning of the tax period as his capital; indeed, the lessee's right to do so is in some respects the stronger of the two, as hereafter pointed out. Such a lease, as applied to this situation, is in every substantial way pro tanto a purchase.

Finally, it is urged that this case is controlled by the decision of the Supreme Court in the Sargeant Land Company case. The mining leases involved in that case and in this one seem to be identical in substance, and it is now said with great plausibility that the ore in the ground and affected by such a lease belongs partly to the lessor and partly to the lessee, and that if the interest of the lessor is not capital assets no more is the interest of the lessee, and that if the receipts of the former are income so must those of the latter be. We are convinced that the analogy between the two cases is superficial and not substantial. In that case the Supreme Court had to determine whether the royalties received by the lessor were income or were a depletion of capital. Many considerations led to the conclusion that they must be treated as income. The contract was a "lease," the receipts were "royalties," and royalties being rentals are inherently income and have been commonly so considered. All these things seem to have affected the conclusion of the court, but after all the dominating thought appears to be that when land is devoted to mining it is put to only one of those productive uses of which it is capable, and that the product of the use should be called income. The land itself is the chief thing. After the mining is finished the land remains suitable for other uses; and the fact, if it is a fact, that the minerals are the greater part of its value can not operate to make the incidental overshadow the principal. These reasons do not apply at all to the case of the lessee, whose existing interest, at the beginning of the taxing period, over and above the royalty which he must pay, amounted to $3,000,000; his entire interest was each year, as far as he went, consumed and exhausted forever; he did not have remaining the principal thing, the land, which he could put to some other use; the receipt in 1910 of his January 1st, 1909, interest in the ore was not the offshoot and income of his property; it was the transformation and eating up of the very property and of the whole of it. We therefore think that applying the principle of the Sargeant case results in holding that these receipts were from the sale of capital assets and not from income.

It results, in our opinion, that, as exemplified in its 1910 operations, the Biwabik's 40¢ a ton profit was income upon which it was properly taxed, and which tax it has paid; but that its 4¢ per ton "capitalized

value" and its 45¢ per ton "increment value" existing January 1st, 1909, but realized during 1910, were not income, and that these items were rightly omitted from its report.

We see no distinction between that value of its interest in the ore as existing January 1st, 1909, which was based upon the amount it had actually paid therefor and that value of its other interest in the same ore at the same time which had resulted from the appreciation of its market value before the taxing law went into effect.

The judgment below must be reversed. Ordinarily a new trial would be awarded, but the record seems to indicate that there is permanent agreement upon all material facts; and, if so, a new trial would be unnecessary. Unless, before the mandate goes down, counsel for the Government indicates a desire for a new trial, the order will be that the judgment be reversed and the court below directed to dismiss the petition. This disposition of the matter will then be of such final character that the case will be ripe for review by certiorari, if the Supreme Court should think review advisable.

98 *Judgment.*

(Filed June 5, 1917.)

Error to the District Court of the United States for the Northern District of Ohio. This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Ohio and was argued by counsel.

On consideration whereof it is now here ordered and adjudged by this court that the judgment of the said District Court in this cause be and the same is hereby reversed and the cause is remanded to the said District Court with directions to dismiss the petition.

*Motion for stay of mandate.*

(Filed June 12, 1917.)

Now comes the United States of America, defendant herein, by E. S. Wertz, United States attorney for the Northern District of Ohio, and represents to the court that the defendant herein intends to apply for a writ of certiorari in the Supreme Court of the United States in the above-entitled case.

Defendant moves the court for a stay of mandate pending the making of such application.

E. S. WERTZ,
*United States Attorney, Northern District of Ohio.*

95 *Notice of motion for stay of mandate.*

(Filed June 15, 1917.)

The plaintiff in error, the Biwabik Mining Company, will take notice that the defendant in error has filed on the 11th day of June,

1917, in the United States Circuit Court of Appeals, 6th Circuit, the following motion:

"Now comes the United States of America, defendant herein, by E. S. Wertz, United States attorney for the Northern District of Ohio, and represents to the court that the defendant herein intends to apply for a writ of certiorari in the Supreme Court of the United States, in the above entitled case.

"Defendant moves the court for a stay of mandate pending the making of such application."

The plaintiff in error will take notice that the said motion will be for hearing on and after the 19th day of June, 1917.

E. S. WERTZ,
*United States Attorney,*
*Attorney for Defendant in Error.*

CLEVELAND, OHIO, *June 13, 1917.*

Service of a copy of the motion of stay of mandate and notice of hearing is hereby acknowledged.

A. C. DUSTIN,
*Attorney for Plaintiff in Error.*

97 *Order staying mandate.*

(Filed June 15, 1917.)

The issue of the mandate of this court upon the judgment heretofore rendered herein is stayed until the disposition by the Supreme Court of the application of the defendant in error for a writ of certiorari, or until the further order of this court.

Enter.

KNAPPEN, *J.*

99 United States Circuit Court of Appeals for the Sixth Circuit.

I, William C. Cochran, clerk of the United States Circuit Court of Appeals for the Sixth Circuit, do hereby certify that the foregoing is a true and correct copy of the record and proceedings in the case of Biwabik Mining Company versus United States of America, No. 2938, as the same remains upon the files and records of said United States Circuit Court of Appeals for the Sixth Circuit, and of the whole thereof.

In testimony whereof I have hereunto subscribed my name and affixed the seal of said court at the city of Cincinnati, Ohio, this 11th day of July, A. D. 1917.

[SEAL.] WILLIAM C. COCHRAN,
*Clerk of the United States Circuit Court*
*of Appeals for the Sixth Circuit.*

100 UNITED STATES OF AMERICA, *ss:*

*The President of the United States of America to the honorable the judges of the United States Circuit Court of Appeals for the Sixth Circuit, greeting:*

Being informed that there is now pending before you a suit in which Biwabik Mining Company is plaintiff in error and the United States of America is defendant in error, No. 2938, which suit was removed into the said Circuit Court of Appeals by virtue of a writ of error to the District of Court of the United States for the Northern District of Ohio, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and
101 removed into the Supreme Court of the United States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the Honorable Edward D. White, Chief Justice of the United States, the eighteenth day of October, in the year of our Lord one thousand nine hundred and seventeen.

JAMES D. MAHER,
*Clerk of the Supreme Court of the United States.*

UNITED STATES CIRCUIT COURT OF APPEALS
*For the Sixth Circuit.*

I, William C. Cochran, clerk of the United States Circuit Court of Appeals for the Sixth Circuit, do hereby certify that the transcript of the record of the proceedings of this court in the within entitled case heretofore certified by me for filing in the Supreme Court of the United States was correct and complete as the same then appeared in this court.

In pursuance of the command of the foregoing writ of certiorari I now hereby certify that on the 25th day of October, A. D. 1917, there was filed in my office a stipulation in the above entitled case in the following words, to wit:

In the Supreme Court of the United States, October term, 1917.

THE UNITED STATES, PETITIONER,
*v.*
BIWABIK MINING COMPANY. } No. 594.

*Stipulation as to return to writ of certiorari.*

It is hereby stipulated by counsel for the parties to the above-entitled cause that the certified copy of the transcript of the record

now on file in the office of the clerk of the Supreme Court may be taken as the return of the clerk of the Circuit Court of Appeals for the Sixth Circuit to the writ of certiorari issued herein.

JOHN W. DAVIS,
*Solicitor General.*
A. C. DUSTIN,
*Counsel for Respondent.*

Oct. 19, 1917.
(184950.)

I further certify that the above is a true and correct copy of said stipulation and of the whole thereof. Witness my official seal, signature, and the seal of said Circuit Court of Appeals at the city of Cincinnati in said circuit this 25th day of October, A. D. 1917.

[SEAL.] WILLIAM C. COCHRAN,
*Clerk of the United States Circuit Court of Appeals for the Sixth Circuit.*

Filed Oct. 25, 1917. Wm. C. Cochran, clerk.

(Indorsed:) File No. 26,061. Supreme Court of the United States, No. 594, October term, 1917. The United States of America versus Biwabik Mining Company. Writ of certiorari. Office of the clerk, Supreme Court U. S. Received Oct. 30, 1917.

(Indorsed:) File No. 26,061. Supreme Court U. S., October term, 1917. Term No. 594. The United States, petitioner, versus Biwabik Mining Company. Writ of certiorari and return. Filed October 30, 1917.

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# In the Supreme Court of the United States.

OCTOBER TERM, 1917.

THE UNITED STATES OF AMERICA, petitioner, *v.* BIWABIK MINING COMPANY. } No. —.

**PETITION FOR A WRIT OF CERTIORARI TO REVIEW THE JUDGMENT OF THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.**

The Solicitor General, on behalf of the United States, prays for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Sixth Circuit in the above-entitled cause.

**STATEMENT OF THE CASE.**

The Mining Company is a West Virginia corporation, engaged under its charter in the mining business. (Rec. 23.) Prior to January 1, 1909, it became the owner, by purchase and assignment, of the leasehold of certain iron mines in Minnesota. (Rec. 24.) The lease was the ordinary mining lease, and did not differ in any material respect from those before this court in the *Sargent Land Company cases*, 242 U. S. 503, 512. (Rec. 28, Ex. A.) The company in making its return for the year 1910 under the corporation excise tax

act deducted from its gross receipts the sum of $265,372.08 "to cover realization of unearned increment." (Rec. 58, last statement in return on top of Rec. 60, Rec. 7 in petition.) Of this amount $21,148.11 was an item of "capitalized value," which will be referred to later. The balance, $244,233.97, was the true so-called "increment value." (See Ex. H, table at bottom showing year 1910.) This so-called "increment value" was reached by *estimating* the actual amount of *merchantable* iron ore left in the mine *on January 1, 1909* (the time the corporation tax act went into effect), *estimating* the value thereof as an entire deposit en bloc on said date (exclusive of royalty) at the sum of 48¾ cents per ton, and then multiplying the number of tons removed *in 1910* by this *estimated* value as of *January 1, 1909*. (Rec. 6, Rec. 25, par. 6, Rec. 26, 27, end of par. 11, Ex. H.) This "increment value" the company deducted from *its gross income*. (Rec. 26, 27, end of par. 11.)

The amount of 48¾ cents per ton as of January 1, 1909, included the item referred to above of "capitalized value," $21,148.11. This item arose from the fact that the company paid $612,000 for its lease. (Rec. 24, par. 2, sub. (c).) This amount was charged up against each ton of ore, presumably as of the estimated amount in the mine at the time it was paid, and, therefore, increased in a small amount the estimated value of the ore. (Rec. 20, 21, opinion of lower court, Ex. H.) The company deducted from its return of gross income this total sum of $265,372.08.

(Ex. G, Rec. 60.) The commissioner assessed a tax upon it and this action was brought by the United States to recover it. Judge (now Justice) Clarke, in the District Court, decided in favor of the Government as to the principal amount—namely, "increment value" $233,233.97—holding that this amount was taxable. (Rec. 16–20.) He, however, decided against the Government as to the small item of "capitalized value"—namely, $21,148.11. (Rec. 20, 21.)

The Court of Appeals reversed the judgment and remanded the case with directions to dismiss the petition. (— Fed. —.)

QUESTION INVOLVED.

It will be seen from the above that the question involved is:

Could a corporation doing business as a *lessee* under the ordinary mining lease which is used in Minnesota on the Mesaba Range fail to return, as part of its gross income accruing to it from all sources during the year 1910, the value in place of the ore sold during 1910 according to its *estimated* value per ton *on January 1, 1909*, or could it deduct this amount under the statutory heading of "depreciation"?

REASON FOR THE ALLOWANCE OF THE WRIT.

1. The decision of the Court of Appeals is directly contrary to the decisions of this Court in *Stratton's Independence Limited* v. *Howbert*, 231 U. S. 399, and *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503.

In *Stratton's Independence Limited* v. *Howbert*, *supra*, this court held that the owner *in fee* of a *gold mine* could not refuse to return as part of gross income, or deduct as "depreciation" the value in place of the ore removed during the taxing year in question, said value being found by deducting from the gross receipts the cost of extraction, etc. The Court of Appeals attempts to distinguish this case on the following ground (— Fed. —):

> Where a mining business is of the character described in the *Stratton's Independence case*, it is clear enough that there is great if not insuperable difficulty in ascertaining the value of the ore in the ground at a fixed date. The whole subject may well be thought too speculative to justify attributing to "depletion of capital" any ore which had been removed. The annual operations of such a mine are expected to and often do develop new ore bodies of even greater value than those removed, Not only are the value and the extent of the ore in place unknown, but the cost of removal is highly uncertain, since it will depend upon unknown and constantly changing conditions. The same considerations apply more or less perfectly to the gas and oil operations and to the coal mining which have been considered in decided cases. These things are so typical of mining operations, as a class, that perhaps we should apply to everything belonging in that general class a general rule which will prevent an appraisal of the ore in place as a

> capital asset at the beginning of the period. The present case does not belong in that class. The parties have stipulated to the extent and value of the ore in the ground on January 1, 1909. Nothing could be more definite or certain. As was said in the statement of facts, this was a quarrying operation. It involved no elements of uncertainty, except those future contingencies which affect the value of all raw materials. In spite of the name of the company, the business more nearly approximated manufacturing than it did mining, as the latter term is commonly understood

This view that mining on the Mesaba Range differs from mining anywhere else is based (so far as it has any basis) on paragraph 4 of the agreed statement of facts (Rec. 24), which is as follows:

> 4. The iron ore body on said property lies in a flat or blanket formation from about thirty to sixty feet below the surface, and the ore is mined by steam shovels after the removal of the surface. The boundaries of said ore body and the depth, quantity, and quality of said ore are capable of determination with extraordinary accuracy by test pits, shafts, and drilling from the surface. Prior to the year 1909 there had been mined and removed from said premises 7,420,114 tons of iron ore, and, in connection therewith, by drilling and by standard recognized methods, defendant had calculated the tonnage and the quality of the iron ore then still remaining upon said premises and had ascertained that said property contained 6,874,695

> tons of merchantable iron ore, all of which was readily and easily minable and removable before the expiration of the date of said contracts, in the year 1948.

The *Stratton's Independence Limited case*, however, in spite of one or two isolated expressions, was not decided on any empirical consideration of the difficulty or lack of difficulty of estimating the value of the ore in place in the case of any particular mine. It clearly went upon the general principle that the proceeds of capital invested in a wasting enterprise was income and that the value of the capital so wasted could not be deducted as "depreciation" (see 231 U. S., pp. 413, 415, 417, 421). And the same view is maintained in *Starton* v. *Baltic Mining Co.*, 240 U. S. 103, where the claim that such tax was one upon capital and not upon income was repudiated *as to all* mining companies. In addition, as pointed out by Judge Clarke (Rec. 17, — Fed. —), the method adopted in the *Stratton case* and condemned by the Supreme Court appears to be a more exact criterion of the value of the ore in place than a mere estimate of its value on January 1, 1909. This latter date seems to have great importance in the minds of some of the lower courts, but its total lack of significance is pointed out by Judge Clark and is demonstrated by the *Brushaber case* (240 U. S. 1).

Finally these very same leases of ore on this very same range were before this court in the *Sargent Land Company case, supra*, and it was held that the *lessor*

could not deduct royalties less expenses under the head of "depreciation." The Court of Appeals distinguishes this case as follows (— Fed. —):

> In that case the Supreme Court had to determine whether the royalties received by the lessor were income or were a depletion of capital. Many considerations led to the conclusion that they must be treated as income. The contract was a "lease," the receipts were "royalties," and royalties being rentals, are inherently income and have been commonly so considered. All these things seem to have affected the conclusion of the court, but, after all, the dominating thought appears to be that when land is devoted to mining, it is put to only one of those productive uses of which it is capable, and that the product of the use should be called income. The land itself is the chief thing; after the mining is finished the land remains suitable for other uses; and the fact—if it is a fact—that the minerals are the greater part of its value can not operate to make the incidental overshadow the principal. These reasons do not apply at all to the case of the lessee whose existing interest, at the beginning of the taxing period, over and above the royalty which he must pay, amounted to $3,000,000; his entire interest was each year, as far as he went, consumed and exhausted forever; he did not have remaining the principal thing, the land, which he could put to some other use; the receipt in 1910 of his January 1st, 1909, interest in the ore was not the offshoot and income of his

> property; it was the transformation and eating up of the very property and of the whole of it. We therefore think that applying the principle of the *Sargent case* results in holding that these receipts were from the sale of capital assets and not from income.

This view of this court's opinion exists only in the imagination of the Court of Appeals. What this court said and decided was (242 U. S. 524, 525):

> * * * We do not think Congress intended to cover the necessary depreciation of a mine by exhaustion of the ores in determining the income to be assessed under the statute by including such exhaustion within the allowance made for depreciation. It would be a strained use of the term depreciation to say that, where ore is taken from a mine in the operation of the property, depreciation, as generally understood in business circles, follows. True, the value of the mine is lessened from the partial exhaustion of the property, and, owing to its peculiar character, can not be replaced. But in no accurate sense can such exhaustion of the body of the ore be deemed depreciation. It is equally true that there seems to be a hardship in taxing such receipts as income, without some deduction arising from the fact that the mining property is being continually reduced by the removal of the minerals. But such consideration will not justify this court in attributing to depreciation a sense which we do not believe Congress intended to give to it in the act of 1909.

Plainly there can be no reason to hold that in leases of this character, where there is in reality a community of interest, the lessor furnishing the fixed capital and the lessee the working capital and labor, the proceeds being divided between them in fixed proportions, the lessor can not deduct that part of his income which comes from exhaustion of capital while the lessee can deduct his. The plausible claim would be the other way. As Judge Clarke says (Rec. 19, —, Fed. —):

> The fact that the defendant was a lessee and not the owner of the ore property it was operating strengthens this conclusion. The defendant had no title to the ore in place, its right being a chattel interest arising from the grant of the privilege of mining and removing the ore. *Traer* v. *Fowler*, 144 Fed. Rep. 810 (to the point 815); *Duffield* v. *Hue*, 129 Pa. St. 94; *Duke* v. *Hague*, 107 Pa. St. 57; *Nonamaker* v. *Amos*, 73 O. S. 163.

It is submitted that the writ should issue as prayed.

JOHN W. DAVIS,
*Solicitor General.*

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# In the Supreme Court of the United States.

OCTOBER TERM, 1917.

THE UNITED STATES OF AMERICA, petitioner,
*v.*
BIWABIK MINING COMPANY.
No. 594.

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.*

**MOTION BY THE UNITED STATES TO ADVANCE.**

Comes now the Solicitor General and moves to advance this case for hearing on a day convenient to the court.

The case involves the question as to what is the true net income, under the Corporation Tax Act of August 5, 1909, of a corporation owning a leasehold of certain iron mines in Minnesota. It is of great importance both as involving the public revenues generally, and as involving the true distinction between capital and income.

If the case be advanced, it is requested that it be set down for hearing on the same date with Nos. 421 and 422 which involve similar principles with

reference to the construction of the Income Tax Act of October 3, 1913.

Notice of this motion has been served upon opposing counsel.

JOHN W. DAVIS,
*Solicitor General.*

OCTOBER, 1917.

# In the Supreme Court of the United States

OCTOBER TERM, 1917.

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UNITED STATES OF AMERICA,
*Petitioner,*

vs.

BIWABIK MINING COMPANY.

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No. 594

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

## MEMORANDUM IN ANSWER TO MOTION.

A. C. DUSTIN,
*Solicitor for Biwabik Mining Co.*

# In the Supreme Court of the United States

OCTOBER TERM, 1917.

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UNITED STATES OF AMERICA,
*Petitioner,*

vs.

BIWABIK MINING COMPANY.

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No. 594

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

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## MEMORANDUM IN ANSWER TO MOTION.

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A. C. DUSTIN,
*Solicitor for Biwabik Mining Co.*

# In the Supreme Court of the United States

OCTOBER TERM, 1917.

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UNITED STATES OF AMERICA,
*Petitioner,*

vs.

BIWABIK MINING COMPANY.

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No. 594

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

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## MEMORANDUM IN ANSWER TO MOTION.

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The Solicitor General of the United States has just served counsel for defendant with notice of the motion filed herein to advance this case with the request that it be set down for hearing on the same date with Nos. 421 and 422, which the Solicitor General says, "involves similar principles with reference to the construction of the income tax act of October 3, 1913."

We concur in the motion to advance this cause, but we believe that it should be set down for hearing in connection with *Emanuel J. Doyle, Collector, vs. Mitchell Brothers' Company,* No. 492, and *United States vs. Cleveland C. C. & St. L. Ry. Co.,* No. 593, and not Nos. 421 and 422. *Doyle vs. Mitchell* and *United States vs. Cleveland C. C. & St. L. Ry. Co.* and the *Biwabik Case*

all three arise under the law of 1909 and involve the same general principles, while the two cases referred to by the Solicitor General arise under the law of 1913 and involve somewhat different principles. The decision of the lower court in *Doyle vs. Mitchell* was reported in 235 Fed., 686, and *United States vs. Cleveland C. C. & St. L. Ry. Co.*, in 242 Fed., 18.

While concurring in the motion to advance we suggest that it be heard on the same date with the latter case.

Respectfully submitted,

A. C. DUSTIN,
*Solicitor for Biwabik Mining Co.*

# In the Supreme Court of the United States

No. 594.

THE UNITED STATES OF AMERICA,

*Petitioner,*

vs.

BIWABIK MINING COMPANY,

*Respondent,*

## BRIEF ON BEHALF OF BIWABIK MINING COMPANY.

A. C. DUSTIN,

*Attorney for Respondent.*

## TABLE OF CONTENTS.



### Authorities Cited.

# In the Supreme Court of the United States

No. 594.

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THE UNITED STATES OF AMERICA,
*Petitioner,*

vs.

BIWABIK MINING COMPANY,
*Respondent,*

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## BRIEF ON BEHALF OF BIWABIK MINING COMPANY.

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This case comes into this Court on certiorari to review a judgment of the Circuit Court of Appeals of the Sixth Circuit.

The suit was originally brought in the District Court of the United States for the Northern District of Ohio by the United States to recover a judgment against the Biwabik Mining Company for $2635.72, upon the claim that the Biwabik Mining Company had wrongfully omitted $265,372.08 from its return of net income for the year 1910 under the Act of Congress, dated August 5, 1909, and was, consequently, indebted to the United States for 1% on that amount with interest.

The petition as originally filed sought to recover some $2,400.00 for the year 1909 also, but it was admitted in the subsequent pleadings and on the trial that this was a mistake; that the amount claimed for 1909 had been paid by the Biwabik Company (under protest) (Rec.

pp. 3, 5, 8, last sentence para. 8, p. 19). The case, therefore, as finally heard and tried was limited to the right of the Government to recover for the year 1910. A jury was waived (Rec. p. 9) and the case submitted to the District Court on the pleadings and on an agreed statement of facts without other evidence (Rec. pp. 16, 17). The District Court found that there was due to the United States $2,422.23, which with interest added at 6% from June 30, 1911, amounted to a total sum of $3,140.70, for which amount the District Court rendered judgment (Rec. pp. 16-17).

Error was prosecuted from this judgment by the Biwabik Company to the Circuit Court of Appeals, where the judgment of the lower court was reversed and the cause remanded with directions to dismiss the petition. Upon the application of the United States (consented to by the Biwabik Company) a writ of certiorari was granted by this Court.

The agreed statement of facts upon which the case was heard in the District Court was embodied in a Bill of Exceptions and the complete record was before the Circuit Court of Appeals and is before this Court.

The petition, answer and reply are found on pp. 2 to 9, the agreed statement of facts on pp. 17 to 48 and the opinion and judgment of the Circuit Court of Appeals on pp. 55 to 65 of the printed record.

We shall in this brief use the terms "plaintiff" and "defendant" as the parties were aligned in the District Court. All page references are to the printed record.

For reasons hereinafter stated we cannot agree with counsel that the word "income" is used in the Act of 1909 and the Act of 1913 with exactly the same meaning, or that the word "received" is the equivalent of "arising and accruing."

The statement made by Government counsel of the facts in the *Biwabik* case are not entirely accurate as we will later point out and are so brief as to require further elaboration.

## STATEMENT OF THE CASE.

The petition contained the following averments:

"The said defendant throughout the years 1909 and 1910 was, and still is, a corporation incorporated and organized for profit under the statutes of the State of West Virginia * * *; that as provided by Section 38 of the Act of Congress, approved August 5, 1909 * * * the defendant made its report or return for the year 1910 * * * as required by Section 38 of said Act.

"That contrary to the provisions of said Act * * * defendant filed an incorrect return for the year ending December 31, 1910, in this, to wit, that the defendant did not include in its gross income the amount of $265,372.08; that said amount was excluded under the pretense of covering the realization of unearned increment.

"Plaintiff says that * * * the defendant wholly failed and refused to pay the taxes as provided for in the said act of August 5, 1909 * * * in the amount of $2,653.72 for the year 1910.

"That the taxes * * * for the year 1910 in the amount of $2,653.70 were not assessed within the time fixed by the statute of limitations, and the defendant declined to execute a waiver as provided by law.

"Plaintiff says the business of the defendant is the mining and production of iron ore; that defendant is not the owner of the lands upon which its mines are located; that the defendant has the right to mine said ore by virtue of the assignment to it of certain mineral leases; that said leases provide for the pay-

ment of royalties on each ton of iron ore mined from the said lands; that said royalties are paid by the defendant to the owners of the fee. * * *

"Wherefore, plaintiff prays judgment, etc."

Defendant in its answer admitted that it was a corporation as alleged; that its business was that of mining and producing iron ore; that it was not the owner of the lands upon which its mines were located and that it mined and produced ore from said lands under and by virtue of the authority conferred upon it by certain contracts, under which it paid 30c per ton to the parties from whom it received its said contracts.

The defendant further in its answer set forth that in the month of June, 1898, for a consideration of $612,000.00 in cash paid by it, and certain promises and agreements contained in a contract it executed, it became the owner of certain mining equipment of the value of $44,614.00 then located on certain premises in St. Louis County, Minnesota, and that in addition thereto and by the contract it then entered into, it acquired and became vested with the exclusive right for the period of fifty years and three months

"to enter upon and explore said premises, and to mine and remove therefrom and sell and dispose of all the merchantable iron ore then on, in, or under said premises, upon payment by this defendant, in installments from time to time, of 30c per ton for each ton so mined and removed; that prior to January 1, 1909, defendant had fully explored said premises, and had developed large bodies of said iron ore, and had mined and removed therefrom large quantities thereof. On said January 1, 1909, said premises contained 6,874,695 tons of said iron ore, all of which can be easily mined and removed during the balance of the term of said contracts, and defendant's vested rights and estate in said premises

and in said iron ore, exclusive of buildings and machinery, on said January 1, 1909, growing out of said contracts were of the value of $3,351,413.81, or 48¾c per ton; that * * * in the calendar year 1910 defendant mined and removed from said premises and sold or otherwise disposed of 544,353 tons of said iron ore and thereby converted into cash a pro rata amount of its capital assets and estate amounting to $265,372.08, no part of which said amounts was income within the meaning of said act of Congress for which defendant was liable to the excise tax of one per cent."

The answer then sets forth that the Commissioner of Internal Revenue as required by the Act of Congress prepared blank forms upon which corporations were expected to make their annual reports and returns and likewise promulgated various regulations and decisions as a guide to corporations in making out their returns. The answer then proceeds:

"That in the preparation of its report for the year 1910 this defendant ascertained and determined its gross income for said year by excluding from its gross receipts for said year the sum of $265,372.08, said sum representing the value of the capital assets of defendant as of January 1, 1909, disposed of and converted into money in said year 1910; that defendant made no concealment thereof, but, on the contrary, showed the deduction by a rider attached to said return in the following words, to wit: 'The amount excluded from gross income for year ending December 31, 1910, to cover realization of unearned increment was $265,372.08.'

"Defendant further says that it intended by the term 'unearned increment' to describe the value of the capital assets of defendant represented by said ore taken out and converted into money during said year 1910, and that while said term is inappropriately used, it is advised and believes that its said report as so made was in accordance with the in-

structions of said Treasury Department and conformed to the interpretation and construction then placed by the Treasury Department on said act of Congress and the rules and regulations of said Treasury Department, and as generally understood and acted upon by other corporations similarly situated."

The answer then proceeds to set forth that the report of defendant for 1910 showed a net income of 206,070.00 and that the tax of 1% thereon (after deducting the special exemption of $5,000.00) was $2,060.70, which was paid by the Company to the Collector and accepted by him; that later in October, 1914, the Treasury Department claimed that the return was incorrect in the respect set forth in the petition.

The reply admits that the defendant acquired the contract under which it took possession in the month of June, 1898, in consideration of the sum of $612,000.00, and that by the contracts the defendant became vested with the exclusive right for the period of fifty years and three months to enter upon and explore the said premises and to mine and remove therefrom, and sell and dispose of all the merchantable iron ore then on, in or under said premises, upon payment by the defendant of 30c per ton for each ton mined and removed as alleged in the answer.

The reply contains the following express admission:

"Plaintiff admits that, as alleged in the answer, prior to January 1, 1909, defendant had fully explored said premises, and had mined and removed large quantities thereof as alleged in the answer, and that on January 1, 1909, the premises contained 6,874,695 tons of said iron ore, and that the value of said iron ore and of said premises, exclusive of buildings and machinery on the said premises on January 1, 1909, growing out of the said contracts, were of the value of $3,351,413.81, or 48¾c per ton,

as alleged in the answer * * *; that during the calendar year 1910 defendant mined and removed 544,353 tons of said iron ore."

In the statement of agreed facts (Rec. p. 17) occurs the following:

"To obviate the necessity of taking testimony, and for the purpose of this case, the parties plaintiff and defendant agree to and do hereby stipulate the following facts to be true, and consent that this case may be heard and determined on said facts."

After reciting the various instruments by which the defendant became vested with its rights in the premises said statement of agreed facts contains the following (Rec. p. 18):

"4. The iron ore body on said property lies in a flat or blanket formation from about thirty to sixty feet below the surface, and the ore is mined by steam shovels after the removal of the surface. The boundaries of said ore body and the depth, quantity, and quality of said ore is capable of determination with extraordinary accuracy by test pits, shafts, and drilling from the surface. Prior to the year 1909 there had been mined and removed from said premises 7,420,114 tons of iron ore, and, in connection therewith, by drilling and by standard recognized methods, defendant had calculated the tonnage and the quality of the iron ore then still remaining upon said premises, and had ascertained that said property contained 6,874,695 tons of merchantable iron ore, all of which was readily and easily minable and removable before the expiration of the date of said contracts, in the year 1948.

"5. In the condition said premises were in on January 1, 1909, the contract of April 4, 1898, and the rights created thereby, exclusive of buildings and machinery on said premises were of the actual value of $3,351,413.81, and the ore in said property, considering the entire deposit thereof *en bloc*, on January 1, 1909, was of the value of 48½c per ton, exclu-

sive of the royalty of 30c per ton provided for in the lease.

"6. Defendant mined and shipped from said property and sold or otherwise disposed of in the calendar year 1909, 542,821 tons of said iron ore, and during the calendar year 1910, 544,353 tons of said iron ore."

Without going over in detail the balance of the agreed statement of facts, it is sufficient to say that it was agreed that the Treasury Department issued the regulations set out as Exhibit "E" (Subdivision 7, p. 19, pp. 36 to 43); that in accordance with the requirements of said regulations the Biwabik Company made an estimate of the fair market value as of January 1, 1909, of the minerals in deposit on said property on the basis of the disposal value of the minerals in total, exclusive of buildings and machinery, and reduced said valuation to the unit tonnage value and prepared and has since maintained an official book record of the property owned by it in connection with which the increment value was claimed, and that it furnished a copy of such official book record to the Department (No. 9, p. 19). A copy of that book record as so kept in accordance with the regulations is attached as Exhibit "H" to the agreed statement of facts (see p. 48).

It appears from number 10 of the agreed statement of facts that the Department made no objection to defendant's return until October, 1914, and then solely because defendant was a lessee and not the owner of the fee of the mine. The contentions of the parties were also incorporated into the agreed statement and appear on pages 20 and 21, and it was there set forth that plaintiff made its first contention that defendant was not entitled to any deduction whatever from gross receipts (or gross

income), for and on account of the iron ore mined, removed and sold from said premises, because it was a lessee, and that plaintiff's second contention was that in any event deduction should be limited to a sum sufficient to return to the defendant the investment it had made in the property back in 1898, that is, what remained of the $612,000.00.

It appears that the defendant's contention was that by the contracts which are set forth as a part of the agreed statement of facts, that it in 1898 acquired,

> "rights or interests in said premises and in the minerals in said land, the value of which on January 1, 1909, was capital assets within the meaning of said act of Congress, and that such value fixed the amount and value of defendant's capital assets and estate on said date, and that to the extent of the value of the ore mined and removed in 1910 (determined on the basis of the salable minerals on the property considered *en bloc* as of January 1, 1909, subject to the payment of 30c per ton when removed), such assets are changed in form only from property into money by the removal and sale thereof, and that the amount of such value shall be deducted from gross receipts of defendant in 1910 before ascertaining defendant's gross income from business for such year.
>
> "(2) That if wrong in the foregoing proposition, and if it was the duty of the defendant under said act of Congress to treat in its report or return its entire gross receipts as 'gross income,' nevertheless the ore mined and sold in 1910 from said property reduced *pro tanto* the value of the capital assets or estate of defendant as they existed in said property on January 1, 1909, and the amount thereof was in any event deductible as depreciation under the provisions of said act of Congress."

It appears from Exhibit "H" (Rec. p. 48) that the general ledger of capitalized value of January 1, 1909, had

become $267,081.90. This was the balance of the $612,000.00 which was paid for the property back in 1898. The net increment value is then set forth as $3,084,331.91. This net increment value added to the general ledger or capitalized value makes the $3,351,413.81 which is the amount agreed upon by the parties as the actual value of the Biwabik Company's interest in the property on January 1, 1909 (Rec. p. 18, subdivision 5). The number of tons of iron ore agreed upon as in the property, divided into the amounts mentioned gives the rate per ton of the *cost* price paid in 1898 as 0.03885 and the rate of increment value as of January 1, 1909, as 0.44865 per ton. These two amounts added together make the 48¾c per ton which is the *agreed* value of the ore considering the entire deposit *en bloc* as of January 1, 1909. The District Court allowed the defendant 0.03885c per ton, the Circuit Court of Appeals allowed both amounts.

## BRIEF AND ARGUMENT.

Section 38 of the Act of Congress of August 5, 1909, so far as pertinent to this case, provides:

> "That every corporation organized for profit and having a capital stock * * * shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation * * * equivalent to one per centum upon the entire net income over and above $5,000 received by it from all sources during such year. * * *
>
> "Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation * * * received within the year from all sources (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its

business and properties, including all charges, such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property. (Second.) All losses actually sustained in business and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property if any. * * *

* * * On or before the first day of March * * * a true and accurate return * * * shall be made * * * to the collector of internal revenue * * * in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall, prescribe, setting forth * * * (third) the gross amount of the income of such corporation * * *," etc.

Under paragraph "Fifth" of the Act, the Commissioner of Internal Revenue may make or require an amended return "within three years after said return is due" whenever an improper return has been made. This clause has been construed in the following cases:

*Bank vs. Gill*, 218 Fed., 600, 602; Affirming same case, 210 Fed., 933.
*Bank vs. Allen*, 223 Fed., 472, 477-8.

Three years having elapsed before any question was raised in respect to the correctness of defendant's return, the plaintiff had no legal right to amend the return. Neither is plaintiff's right of action predicated on the "return" made by the corporation itself. It is based on the theory that the law in terms created the obligation to pay, out of which the cause of action arises. (*U. S. vs. Grand Rapids & Indiana Ry. Co.*, decided by Sessions, D. J., Feb. 25, 1915.) If common law forms of action were used today, this suit would be in form an action for debt. We have here analyzed plaintiff's cause of action not for the purpose of claiming that it is barred by the three-year limitation, but only to point out that neither

plaintiff's *right* of recovery nor defendant's defense is affected in any manner by the correctness or incorrectness (in a technical sense) of the "return" as made by the defendant.

We may, therefore, dismiss the question of defendant's return from further consideration and come to the real question before us, is there an indebtedness due the plaintiff from the defendant under said Act of Congress growing out of the business carried on by defendant in the year 1910.

It is too clear for argument that this revenue law contemplated that every corporation affected by its terms was doing business and had property of some value. The law did not concern itself with the character of the property or the cost thereof. Its value on January 1, 1909, was the result of past conditions with which the tax law was not concerned. This value might be one-tenth of or ten times the original cost.

Whatever was the real value on January 1, 1909, that was the capital of the corporation. It may properly be characterized as capital assets to distinguish it from income thereafter accruing. The law did not propose to exact anything on the capital itself, or the distribution thereof, but did propose to exact 1% of any net income received in carrying on business with this capital. All business corporations, with certain exceptions specifically set forth in the Act come within the terms of the law and limited to such exceptions Congress must have intended that all corporations should be treated alike.

While the law in terms specifies the deductions that are to be made from "the gross amount of the income" to determine the "net income" it is silent on what shall

constitute "income" the "gross amount" of which is the starting point. The determination of what Congress meant by "income" was left to the common understanding "as that term is used in every day life." *Bundy vs. Nygaard*, 163 Wis. 307.

In express terms the statute made it the duty of the Treasury Department to promulgate regulations adapted to carry the law into effect. This the Treasury Department did. It interpreted the law to permit the deduction from gross receipts of the value of the capital assets disposed of, and issued appropriate regulations covering this subject, which are incorporated in the record in this case (pp. 36-43). Pursuant to the regulations defendant made its return for the year 1910.

The very clear analysis of this case in the statement of facts and opinion by the Circuit Court of Appeals (Rec., pp. 55-65) leaves very little to be said.

In reference to the decision of the District Court in allowing defendant to deduct from gross receipts the amount paid in cash by the defendant back in 1898 and refusing to allow the deduction of the actual value as of January 1, 1909, the Circuit Court of Appeals pertinently said (Rec., p. 65):

> "We see no distinction between that value of its interest in the ore as existing January 1st, 1909, which was based upon the amount it had actually paid therefor and that value of its other interest in the same ore at the same time which had resulted from the appreciation of its market value before the taxing law went into effect."

Denison, C. J., speaking for the Circuit Court of Appeals said:

> "This statute measures taxation by net income. It declares the net income to be what is left after certain deductions from gross income. Obviously,

we can make no headway in applying this measure until we define 'gross income,' and it is equally sure we can only learn what 'gross income' is by first defining 'income.'

"It is urged that we are not concerned with the meaning of 'income,' because under this statute income is not the thing taxed, but is the measure of taxation. We do not appreciate the force of the claimed inference. Income is a word capable of definition. Of course, its definition may cover a variety of specific meanings, and its context may determine which specific meaning should be accepted; but no reason has been suggested, and none occurs to us, why the mere fact that the term is used as a yardstick for measuring taxation or something else, rather than as describing the thing upon which the tax rests, should indicate that one or another specific meaning is the right one. It is well known that Congress was driven to tax the privilege (according to its value as indicated by its net income) because of the failure of the law taxing 'income' directly; and—to say the least—there can be no presumption that between the old law and the new one Congress had changed its idea of what the word 'income' meant. When reduced to final terms, to say that 'income' in this law does not mean generally the same thing as it does in income-tax laws is to say that levying upon the income of a company a tax of one percent will produce ten dollars, while levying upon the franchise of that company a tax of one per cent of its income may produce twelve dollars; and we can not approve that proposition.

"It would have been perfectly natural for Congress to decide that the tax which it was to impose upon the privilege should be measured either by the amount of business done thereunder or by the proved value of the privilege. Either would have been a logical basis for such taxation. If the former had been the adopted theory, the tax would have been measured by *total receipts*, or by *total sales*, or by *total disbursements*, or by some combination of

these measurements, and any thought of profits would have been utterly foreign to the scheme of measurement. The most casual inspection of the law shows that this theory was not adopted. On the contrary, all ordinary expenses and losses in the conduct of the business were expressly to be deducted, and only the remainder was to be taxed. Whether this remainder happened to be called net income or net profits was a matter of no consequence; by either name it was the same thing. It is of the essence of the law that a corporation doing a business of $100,000 and making $50,000 profit is to be taxed one per cent upon that profit, less the exemption, or $450, while a corporation doing a business of $10,000,000 and making no profit is not to be taxed at all. It is clear to a demonstration that Congress deliberately intended to tax the franchise according to its actual value to the user as determined by the annual profit derived therefrom, without regard to its value as indicated by the amount of business done.

"So, too, it is urged that we should not be concerned with this definition, because the statute itself carefully defines what the tax upon income shall be. As has been pointed out, this idea rests upon a clear misapprehension of the statute; the law does not purport to do this or anything like this. The statutory computation rests upon the assumption that we already know what income is as distinguished from other matters; otherwise, it would be impossible to state that gross income which is the foundation of that statutory computation.

"We, therefore, are confirmed in our opening statement that to rightly interpret this law we must interpret and define 'income.' It must, by certain attributes, be distinguished out of the mass, or from other things with which it is compared. Distinctive definitions involve contrast. Since the law specifies 'income' and not 'sales' or 'receipts' or 'capital and surplus,' or any other standard of measurement which might have been named, what should be set over against 'income' to bring out this dis-

tinctive character. In every case in the Supreme Court and in the lower courts, including and since the Stratton's Independence case, it has been assumed that the receipts and accumulations of a business corporation are of two classes—one those which constituted its gross income and the other those which represented the sale or conversion of its capital; and the controversy has always been as to the respective definitions of those two classes. We accept this as the rightful criterion, not only because it has been universally accepted, but because we think it must be right. The only alternative is to say that all receipts from the conduct of a business according to its intended plan are income. To say this is to destroy the effect of carefully selected words. It would involve the conclusion that in case of a company organized to buy land and subdivide and sell lots, all receipts from the sales of lots were 'gross income,' even though the lots were all sold and the invested capital not realized; and that, since only disbursements made during the year can be deducted, the capital so invested in one year and realized the next year would be taxable net income. So far as words are concerned, it is impossible to say that the law did not intend to go to that very extent; but to say so would be such a departure from the administrative practice and rules which have prevailed from the beginning, and from what we think the law has always been assumed to mean that we are unwilling to take so radical a step. So we come to what we deem the decisive question, viz. 'So far as the selling price of the ore in 1910 represented its acual value to the company in the ground on January 1st, 1909, was it income or was it the sale price of capital assets?' " (Italics mine.)

Congress must be held to be able to express its meaning with accuracy, and if it had intended to tax "receipts" instead of "income," it would have employed words appropriate to express that idea, just as it did in the War Tax Act of June 13, 1898, when it levied an

excise tax upon the gross annual receipts in excess of $250,000.00 of any corporation or Company carrying on or doing the business of refining sugar (30 Statutes at Large 448).

*Spreckles Sugar Refining Co. vs. McLain*, 192 U. S., 397.

It wanted to tax gross receipts under that law and it said so.

As pointed out by Judge Denison above, it might have done so in the law of 1909, but it did not elect to start with gross receipts and then after making certain deductions tax net receipts, but it started with gross amount of income. The law of 1909, as pointed out by Judge Denison, was intended to enact a tax law which would meet the decision of this Court in the Pollock case. Congress, to our mind, by the selection of the words employed intended to exclude from gross receipts the part thereof represented by the conversion of capital into money, and because of that it used the word "income" throughout this law instead of "receipts."

In the case of *Doyle, Collector vs. Mitchell Brothers Company*, 235 Fed. Rep., p. 686, 687, Judge Denison said:

> "It is clear that, by the term 'income,' Congress did not intend to include the proceeds of capital assets sold or converted during the year; nor can it be material whether such proceeds are reinvested in other property or remain in the treasury of the company or are distributed to the stockholders; nor whether, in case of such distribution they are called dividends or capital. The controlling question must be whether assets so converted were, in fact, at the beginning of the tax period, properly to be classed as capital assets. If they were of that character, they cannot be 'income' received during the later period; they represent merely capital in a changed form * * *."

It will be noted that the Biwabik case was decided by the same court as the Doyle-Mitchell case. Counsel below attempted to distinguish the Biwabik case from the Doyle case. We there contending that the two cases involved the same principle and should be decided in the same way.

In respect to this contention Judge Denison said, (Rec., p. 62):

> "In its general aspect this question is the same as that discussed in *Doyle vs. Mitchell*. We may here refer to that opinion, without repeating it at length, for the matters there stated. Unless that case was wrongfully decided, the question must be whether this case is to be distinguished in principle.
>
> "Certainly there is no great difference in the inherent character of the assets transferred and sold. The ore below the surface and the trees above were interests in realty until they were severed. Upon severance and preliminary treatment each became the raw material for further process of manufacture. The extent and quality of each before severance were determined by expert appraisal. Each before severance had a known and realizable market value. Each had been purchased in its unsevered form by the company taxed, and each, while still in that form, had increased in market value after the purchase and before the law was passed, and had then further increased before severance, and in each case the market value when the law went into effect had been ascertained and stated accurately and in good faith. What are the distinctions urged?
>
> "The first is that the company was a mining company and not a manufacturing company. The law makes no such distinction, and there can be no magic in the word 'mining' as part of a corporate name. Where a mining business is of the character described in the Stratton's Independence case it is clear enough that there is great if not insuperable

difficulty in ascertaining the value of the ore in the ground at a fixed date. The whole subject may well be thought too speculative to justify attributing to 'depletion of capital' any ore which had been removed. The annual operations of such a mine are expected to and often do develop new ore bodies of even greater value than those removed. Not only are the value and the extent of the ore in place unknown, but the cost of removal is highly uncertain, since it will depend upon unknown and constantly changing conditions. The same considerations apply more or less perfectly to the gas and oil operations and to the coal mining which have been considered in decided cases. These things are so typical of mining operations, as a class, that perhaps we should apply to everything belonging in that general class a general rule which will prevent an appraisal of the ore in place as a capital asset at the beginning of the period. The present case does not belong in that class. The parties have stipulated to the extent and value of the ore in the ground on January 1st, 1909. Nothing could be more definite or certain. As was said in the statement of facts, this was a quarrying operation. It involved no elements of uncertainty, except those future contingencies which affect the value of all raw materials. In spite of the name of the company, the business more nearly approximated manufacturing than it did mining, as the latter term is commonly understood."

In passing, while not involved in the Biwabik case, because of the peculiar nature of the ore deposit as above pointed out, it may be doubted whether the exception above suggested by Judge Denison, even as to the ordinary mining companies, is sound. There is in reality no serious difficulty in determining the fair value of an ordinary mining property at a particular date.

*Montana Railway Co. vs. Warren*, 137 U. S. 348, 352, 354.

The law of 1909 clearly intended to adopt the value of capital assets as of January 1, 1909, of all corporations affected by that law, consequently, the actual value on that date of the capital assets of such corporation becomes a question of fact to be established like any other fact.

We have read with a great deal of interest the lengthy and interesting discussion by counsel for the government of the meaning of the words "income," "capital," "fixed capital" and "floating capital," and the language quoted by government counsel from the opinion of Lord Chancellor Halsbury in *Dovey vs. Cory*, (1901) A. C. 447, 486-487, appears very appropriate:

> "I doubt very much whether such questions can ever be treated in the abstract at all. The mode and manner in which a business is carried on and what is usual or the reverse, may have a considerable influance in determining the question what may be treated as profits and what as capital. Even the distinction between fixed and floating capital which may be appropriate enough in an abstract treatise like Adam Smith's 'Wealth of Nations' may with reference to a concrete case be quite inappropriate."

The same general line of discussion of authorities was made to the Circuit Court of Appeals in the Doyle-Mitchell case and the Biwabik case, and in reply to this discussion Judge Denison very pertinently said (235 Fed., 688):

> "This law was passed to make a workable system of raising revenue and not to provide exercise in dialectics."

The very brief statement by government counsel of the Biwabik case (their brief, p. 7-8) is erroneous in so far as it states that the value of the deposit *en bloc* was

"estimated." This error probably arose out of the fact that the regulations of the Treasury Department called for the preparation of an "estimate" as of January 1st, 1909, (Regulations 83-89, Rec., pp. 37, 38) of the capital value for the purpose of making up the tax returns in accordance with which the Biwabik Company prepared its official record book (No. 9, p. 19). In the *trial of the case*, the value was not "estimated," but actually agreed to both in the pleadings and in the agreed statement of facts.

The Biwabik case is placed by the government counsel in Group 2 (Brief, pp. 5 to 7). On p. 34 counsel for the government says the property involved in the cases in Group No. 2 "appreciated in value between the time of purchase and the beginning of the taxing year." This statement is misleading as to Biwabik and the Doyle-Mitchell, and probably several other of these cases in this group. The "appreciation" referred to took place not merely prior to the taxing year, but prior to the period when the law itself became effective. No one claimed in the lower court and it was not there held that appreciation accruing *after* the law became effective but prior to the taxing year should not be treated as income when "received." This inaccuracy of statement may explain the difficulty counsel encounters in interpreting the word "received" as applied to income under the law of 1909. This difficulty will disappear if it is borne in mind that Congress in passing this law must be held to have intended a permanent, not a temporary or one year law. It was designed to reach and tax "income" in the year when "received" whether such income was the product of that year or several past years. The word "received" was intended to supply the omission in that

respect of the income tax law passed during the Civil War, as interpreted in *Gray vs. Darlington*, 15 Wallace, 63. There is nothing however, which indicated a purpose on the part of Congress to make the law retroactive. The law began with January 1st, 1909, and accepts as the "static condition" that moment of time (to employ the language of the government counsel, their brief, p. 33), as determinative of the capital assets of the corporation:

> "* * * there is a presumption against retrospective operation, and we have said that words in a statute ought not to have such operation 'unless they are so clear, strong and imperative that no other meaning can be annexed to them, or unless the intention of the legislator cannot be otherwise satisfied.'" McKenna, J., 202 U. S. 577, *United States vs. American Sugar Company.*

That in the interpretation of taxing statutes their provision will not be extended by implication, but in cases of doubt will be most strongly construed against the government, was re-affirmed by this court in *Gould vs. Gould*, decided December 19, 1917.

The injustice of a tax law, which, taking effect on a particular date would nevertheless attempt to attach to the value of property on that date the *cost* price instead of the real value is self-evident. Take an example of three corporations owning on January 1, 1909, properties of equal value, worth say $1,000,000.00 each; assume that one corporation acquired its property on December 31, 1908, paying the full value therefor, $1,000,000.00; one acquired its property ten years previous paying $100,000.00 therefor, and one had owned its property for fifty years, the original cost price to it being merely nominal. It would perhaps be constitutional for a legislature to pass an income tax law so framed as to make the cost price the determinative factor and treat the capi-

tal assets of one of these companies as $1,000,000.00, another $100,000.00 and the third as nothing, but the law would certainly have to be very clear and specific in its terms before the court would adopt a construction which would lead to results so unequal.

That the status of property is to be regarded as fixed and to be treated as capital of the taxpayer on the date when the law became effective was distinctly held in *Bundy vs. Nygaard*, 163 Wis., 307.

What is clearly capital to the corporation may under certain circumstances and under certain statutes become income *to the stockholders* when divided and declared by the corporation as a dividend. Failure to recognize this distinction, so plainly pointed out in *Moon vs. Wisconsin Tax Commission*, 163 N. W., 639 (Nos. 5 & 6, p. 640; Winslow, C. J., 641) is responsible for the remark of government counsel found on the bottom of p. 45 of his brief.

But it is said the Biwabik Mining Company's interest in this property was obtained under a lease and that as such lessee it was not the *owner* of the *ore*, and was not, therefore, when it sold the ore converting its capital assets into money.

Whether these contracts of lease effected an *absolute* sale of the ore or not is wholly immaterial. It is settled that they do create an interest in real estate of a permanent character which cannot be divested so long as the contract provisions are complied with. Such a lease as we have here is recognized as property and is frequently sold and dealt in in the same way as other property. In 1898 the defendant paid $612,000 for this lease, which was on January 1, 1909, of the agreed value of $3,351,413.81. That a lessee of a mine has a vested estate is well settled.

The position of the government is in effect that the interest is a mere license to take the ore on payment of the 30 cents per ton. The distinction between such an estate as we have here and a mere license is well recognized.

We quote from II Snyder on Mines, § 1143:

"A mining *lease* may be defined to be a contract between the owner, generally called the lessor, and the miner, generally called the lessee, whereby the latter is authorized to take and hold possession of certain mining claims or mining property or portions of mines for a fixed period of time, or while a certain quantity of its product may be obtained, for a stipulated compensation in specie or in money."

§ 1390. "A *mining license* is an authority to go upon the land of another and to mine or otherwise secure the mineral contained therein, whether in the form of ore, coal, oil or gas, and appropriate the same to the use of the licensees, under such circumstances as that the act would be a trespass except for such authority, and generally carrying no permanent interest in the land."

§ 1394. "There is a wide distinction between a lease of mines and a right to work them. The former is a distinct conveyance of an actual interest or estate in lands for a term long or short, while the latter is simply an authority to do a certain act or series of acts upon another's land without possessing any estate therein; a mere incorporeal hereditament, to be exercised in the lands of others."

§ 1397. "Where the instrument creates an interest and exclusive right of possession in the land and is essentially assignable, unless there is a prohibition to the contrary, it must necessarily be construed as a lease, and it matters not the period of duration of the interest; it is sufficient that one is created."

In *Wheeler vs. West*, 71 Cal., 126, it is said (p. 129):

"There is a broad distinction between a lease of a mine under which the lessee enters into possession and takes an estate in the property, and a license to work the same mine. In the latter case, the licensee has no permanent interest, property, or estate in the land itself, but only in the proceeds and in such proceeds not as realty, but as personal property, and his possession, like that of an individual under a contract with the owner of land to cut timber, or harvest a crop of potatoes thereon, for a share of the proceeds, is the possession of the owner." (Citing authorities.)

In *Boone vs. Stover*, 66 Mo., 430, the court said (p. 434):

"It is proper to notice the characteristics which distinguish a lease from a license * * *. By a lease, the lessee obtains an estate in possession of the land and its products, in respect to which he can maintain ejectment; but in a license, or grant of an incorporeal hereditament, the grantor does not divest himself of the possession, and the liberty of working a mine or mines on it is not inconsistent with the retention of possession by the grantor."

In *Barnsdall vs. Gas Company*, 225 Pa., 338, the second section of the syllabus reads as follows:

"There is a broad distinction between a lease of a mine, under which the lessee enters into possession and takes an estate in the property, and a license to work the same mine. In the latter case, the licensee has no permanent interest, property or estate in the land itself, but only in the proceeds and in such proceeds not as realty, but as personal property and his possession is the possession of the owner. A contract simply giving the right to take ore from a mine, no interest or estate being granted, confers a mere license, and the licensee acquires no right to the ore until he separates it from the freehold. But an instrument that demises and leases certain lands for mining purposes only, for a desig-

nated term of years at a fixed rent, and giving the right to erect all necessary buildings, etc., is a lease and not merely a mining license."

(See Record, Exhibit D, pp. 34, 35; Ex. C, pp. 29-34, for copies of lease.)

Lord Blackburn in *Coltness Iron Co. vs. Black*, 6 App. Cas. 315, 335, said:

"It was said by Lord Cairns in *Gowan vs. Christie*, Ex. D, 23, that a lease of mines 'is not in reality a lease at all in the sense in which we speak of an agricultural lease. There is no fruit; that is to say, there is no sowing and reaping in the ordinary sense of the term and there are no periodical harvests. What we call a mineral lease is really, when properly considered, a sale out and out of a portion of the land.' I think this is a perfectly accurate statement."

See also:

*Stoughton's Appeal*, 88 Pa., 198, 201, 202;
*Scranton vs. Phillips*, 94 Pa. 15, 22;
*Eley's Appeal*, 103 Pa., 300;
*Delaware, L. & W. R. R. Co. vs. Sanderson*, 109 Pa., 583.

Denison, C. J., speaking for the Circuit Court of Appeals below said (Rec., p. 63):

"It is next said that the company was not the owner, but only a lessee; indeed, the internal-revenue department made this the controlling fact, since by its rules and regulations it permitted mining companies who owned the fee of the lands in which the ore was located to treat as capital assets the value of their ore in the ground at the beginning of the year, if they were able to ascertain that value, but the department refused to extend this ruling to cases were the mining company was only a lessee (Regulation 75, supra; but see also Regulation 91, supra.) It is difficult to appreciate the supposed distinction. This company was removing 500,000

tons per year. The deposit was six million tons. There were thirty years remaining of the period permitted for removal. The lessee's interest could be and had been bought and sold, and it had been salable for the stipulated price at the beginning of the taxing period. Counsel for the government has not pointed out the reason for this distinction made by the department. We suppose it must lie in the thought that since the lease may be forfeited or given up before the ore is all removed the annual operations must be treated as an annual purchase from the lessor, at the royalty price, of the amount each year removed, and so all the value realized above the royalty must be income for the year. We doubt the force of this construction. It comes to saying that what would otherwise have been capital at the beginning of the year must not be so treated, because the company might have elected or been compelled to forfeit to one who had an underlying claim, or to saying that the owner of mortgaged mining property could not consider the existing value of his equity as his capital, because if conditions changed he might lose it by foreclosure. We think that the lessee of such property and under such a lease is as much entitled as is the owner of the fee to treat the value of his interest in the ore in the ground at the beginning of the tax period as his capital; indeed, the lessee's right to do so is in some respects the stronger of the two, as hereafter pointed out. Such a lease, as applied to this situation, is in every substantial way *pro tanto* a purchase."

Judge Denison then distinguishes this case (see Rec., p. 64) from the Sargent Land Company case in this Court, pointing out that royalties could very properly be treated as simply rentals so far as the lessor is concerned; the use of the land for mining purposes being only one of the many uses to which such land could be put, the land itself being the chief thing, and then proceeds:

"These reasons do not apply at all to the case of the lessee, whose existing interest, at the beginning of the taxing period, over and above the royalty which he must pay, amounted to $3,000,000; his entire interest was each year, as far as he went, consumed and exhausted forever; he did not have remaining the principal thing, the land, which he could put to some other use; the receipt in 1910 of his January 1st, 1909, interest in the ore was not the offshoot and income of his property; it was the transformation and eating up of the very property and of the whole of it. We therefore think that applying the principle of the Sargeant case results in holding that these receipts were from the sale of capital assets and not from income."

It should not be overlooked that after giving the Biwabik Company full credit for the value of its capital assets thus converted into money there was *left a large net income in 1910 upon which it paid the taxes assessed by the government.* This construction of the Act of 1909 simply places the Biwabik Company on a parity with other corporations. It gives it the benefit of the realization of its capital assets as they existed on January 1, 1909.

The government counsel cites *Klar Piquett Mining Co. vs. Plattville,* 163 Wisc., 215, as opposed to the decision of the Circuit Court of Appeals below on the subject of the nature of the estate of a lessee company. It is only necessary to read that case to appreciate the logic by which the result was reached. That logic in effect when applied to our case is, either that defendant has the rights of a license only to go on the property each year and take out the ore, upon payment of 30 cents per ton, or else that the 30 cents per ton agreed to be paid back in 1898 (which was probably then plus about $600,000 the full value of the ore) must be regarded *as the value*

*on January 1, 1909, to the lessee notwithstanding the fact that on the latter date the real value of the ore was 78¾ cents per ton.* To whom does this appreciation in value from 30 cents per ton to 78¾ cents belong if not to the lessee?

The successive acts of Congress imposing income taxes beginning with the laws of 1861 are to be regarded in a sense as parts of one uniform system to tax income. The laws passed after 1909 must be regarded as supplementary or complementary to the laws they severally replaced, the later ones clarifying, restricting or expanding the ones repealed.

*Black on Income Taxes*, §§ 30, 31 and cases cited.

In passing the later laws Congress must be held to know how the previous ones were interpreted by the department charged with their administration, as well as by the courts. The subsequent acts of Congress in the light of the interpretations of previous laws may show what Congress *intended* by the earlier laws. The treasury rulings, therefore, while not conclusive, may in the light of the history of the legislation be of paramount assistance to us.

"Income" as commonly understood in every day life is something which leaves ones "capital" intact. In *Secretary of State in Council of India vs. Scoble* (1903), A. C. 299, 302, Lord Chancellor Halsbury in defining income said:

> "I think it cannot be doubted upon the language and the whole purport and meaning of the income tax acts that it never was intended to tax capital * * * as income at all events."

And Lord MacNaghten in *London City Council vs. Attorney General* (1901), A. C. 26, said:

"In every case the tax is a tax on income, whatever may be the standard by which the income is measured. It is a tax on 'profits or gains' in the case of duties chargeable under Schedule (A), and the expression 'profits or gains' is constantly applied without distinction to the subject of charge under all the schedules."

"Mere advance in value in no sense constitutes the gains, profits or income specified by the statute. It constitutes and can be treated merely as increase of capital."

Field, J., *Gray vs. Darlington*, 15 Wall. 63.

This is especially in point as to such appreciation in the capital of the Biwabik Co. as occurred between 1898 and 1909.

Any one who is in business and spends his *entire receipts* on the theory that they are income without inquiry whether such "receipts" were not partly a realization of capital is quite likely to be rudely awakened. This is particularly true of one engaged in converting into marketable form a *capital estate*, as timber or ore. What did the law of 1909 mean by this term "income" is the question. We believe the administration of that law and the text of the later Acts will be helpful in answering this question.

As early as December 3, 1909, the Treasury Department (T. D. No. 1571 Dec. 3, 1909) defined the term "gross income" of mining companies to be the same as "gross profits" and this early ruling was followed by a series of rulings with respect to sales of "capital assets" and the deduction from "gross receipts" of the business an amount to represent such value, when such assets were converted into money. (Rec., pp. 36-38.)

These decisions were not always harmonious but the principle was clearly recognized (if not always clearly

expressed) by both decisions and regulations, that the law was designed to give due credit for the "capital assets" of mining companies as they existed on January 1st, 1909. Sometimes the word "depreciation" is used with quite different meanings (Exhibit "E," Rec., pp. 36-41). Thus "depreciation in value of mines by removal of ore * * * may be *prorated* as a sale of capital assets." (T. D. 72, Rec., p. 36.) (Pro rating was, of course, unjustified unless the real value on January 1st, 1909, could not be ascertained. That question is in Case No. 327 heard with the Biwabik case.)

Under the title "Depreciation in Minerals, etc." (Rec., pp. 37-38) a deduction from gross receipts of mines was directed to be made of the value of the ore taken out in the taxing year determined from an estimate of the value of the entire deposit *en bloc* as of January 1, 1909. This amount was not to be included in "gross income" at all. In this sense (depletion for ore extracted) the Treasury Department evidently used the word "dereciation" in Treasury Decision No. 1606 (see No. 73, Rec., p. 36), where if the corporation took depletion in excess of 5% a special explanation was required. Why the department selected 5% is not entirely clear, but it is a matter of public knowledge that the Treasury Department attempted to justify this ruling on the theory that 20 years was the average life of mines. This 5% regulation (which the department considered adequate unless special explanation was made) is important only because when Congress came to repeal the law of 1909 and enacted the law of 1913 to take its place it adopted this 5% limitation, and in express terms provided for "an allowance for depletion of ores * * * not to exceed 5%." (See Law 1913 Government Brief, p.

107). In the law of 1916 (Sec. 12) (Replacing the law of 1913) the depletion allowance was changed from 5% to full value with the proviso that when there had thus been taken the full value nothing more should be allowed.

We have here a consistent system or plan of income tax legislation clearly designed by Congress to give mining corporations credit for capital assets converted into money. The Act of 1913 (passed with full knowledge of the regulations mentioned) aiming to be specific as to the extent of such deduction, clearly adopted the treasury suggestion by limiting the amount to 5%. This was not an extension or enlargement of the law of 1909, but a recognition of the plan already put into effect by the department under that law. The law of 1916 increased the depletion allowance to the full amount thus in effect returning to the law of 1909 as construed by the department. Had Congress in the later laws taken away the right of deduction all together, it might be urged that the Treasury Department had misinterpreted what Congress intended to be the meaning of the law of 1909; but the contrary is the fact as I have pointed out.

I stated in the early part of this brief that I did not agree with counsel's contention that there was no difference between the Acts of 1909 and 1913 with respect to the words therein employed. The comprehensive definition of the income of natural persons (Government Brief, pp. 100-101) includes all receipts of the character therein specified—the net income to be ascertained by deducting therefrom the several deductions and allowances thereafter specified. The definition of the income of corporations in the Act of 1913, while employing somewhat different language than that with respect to natural

persons, was intended to be as comprehensive as the other. (Government Brief, pp. 105, 106). That different words were used was more likely due to inadvertence than design. This inadvertence clearly appears in some parts of the law. For instance, the income of natural persons is broadly defined under (b) (Government Brief, p. 100) to include what practically amounts to gross receipts, the net income being defined to include all such receipts less the exemptions and deductions thereafter specified. The allowable deductions are then shown (Brief, p. 101), which include under (Sixth) a reasonable allowance for the *exhaustion, wear* and *tear* of property arising out of its use or employment in the business, not to exceed in the case of mines five percentum, etc. The *return* required of natural persons (Brief, p. 103) is required to set forth the income from all sources and "from the total thereof deducting the aggregate items of expenses and allowances herein authorized," without again enumerating them. With respect to corporations the law provides that the normal tax upon natural persons shall be levied and assessed upon "the entire net income of corporations arising or accruing from all sources." (Government Brief, p. 105.) The net income is then to be ascertained by deducting from the gross income certain things specified, among which are "(Second) All losses actually sustained * * * including a reasonable allowance *for depreciation by use, wear and tear of property if any; and in the case of mines a reasonable allowance for the depletion of ores * * * not to exceed* 5%, etc." (Brief, pp. 106, 107.) The return of corporations, unlike that of natural persons must give certain information and then make the deductions which are again enumerated instead of referring back to the prev-

ious enumeration. The amount of depreciation is required to be separately set forth, but nothing need to be said about the "depletion of mines," which under "Second" above the corporation is permitted to deduct. It is probable as above stated that this failure to enumerate "depletion" in the return to be made was an inadvertence. That this is so is shown by the Act of 1916 where there is no specific enumeration of what the corporate return shall contain, reference being made back to the previous provisions of the Act in the same way as in respect to the returns of natural persons. (Act of Sept. 8, 1916, Sec. 8 (b); Sec. 13 (b).) In both the income tax law of 1913 and 1916 the word "income" is defined in the law itself when all parts are taken together, and seems to be as comprehensive as "receipts" leaving nothing to inference, and it was proper therefore to provide specifically for deductions therefrom of "depletion."

As bearing upon the intention of Congress to be gained by a study of all three laws I wish to call the Court's attention to the fact that under neither the law of 1909 nor 1913 was there any provision with respect to the plan to be adopted in computing the gain derived on sales of property; with the result that in some cases the Treasury Department ruled that the appreciation in value of property acquired before the laws took effect and sold afterwards, should be apportioned over the interval of ownership instead of the actual value on the *date* the law took effect. (These decisions were not in harmony with the rulings with respect to mining companies.) There was considerable controversy over the subject, and Congress proceeded in the law of 1916 to make the matter very clear and distinct by providing that on such sales

"the fair market price or value of such property as of March 1, 1913, shall be the basis of determining the amount of such gain derived or loss sustained."

By treating all of the various Acts of Congress as part of a general plan or system in connection with the Treasury decisions and regulations, we obtain the best proof of what Congress intended by the earlier acts. This is of course subject to the proviso that the words there employed may be said to be sufficiently ambiguous to call for construction. Of course, if the words have a clear and definite meaning, there is no room for construction. But can that be said of the word "income" in the law of 1909, when applied to all the varying circumstances of business. That there was and is uncertainty as to what the term meant is demonstrated by the conflict in decisions of the various courts and that necessity of elaboration shown in this case by the lengthy brief on that subject by government counsel.

We, therefore, conclude that the interpretation placed upon the law of 1909 by the Treasury Department from the very beginning and under which that law was administered during its whole life is entitled to great weight.

*Swan & Finch Co. vs. United States,* 190 U. S. 143, 146.

Such interpretation must be held to be conclusive as above pointed out if the words employed in the Act are susceptible of any ambiguity.

The Sargeant Land Company case (242 U. S. 503) is distinguished by Judge Denison from the Biwabic case (Rec., p. 64), and with that opinion I am content.

In the Sargeant case, as well as in the Independence Mining Company case, the argument presented and

urged upon the court was that the companies were not engaged in business at all, but simply realizing by way of sale on capital assets, and that the *entire* receipts were the proceeds of such sales, and that the government was entitled to nothing; that the corporations had no income whatever.

The Sargeant case decides that the term "depreciation" as used in the Act of 1909 was used "in its ordinary and usual sense as understood by business men," and was designed to cover "wear and tear and obsolesence of structures, machinery and personalty in use in the business" and not intended to cover depletion or exhaustion of ore deposits. The fact that the royalties there paid were in a true sense rentals for the use of land, the land itself, which was the principal thing, being left for other useful purposes, there was no state of facts from which it could be claimed that the value of the ore constituted the entire value of the estate of the Sargeant Company. This was sufficient to distinguish that case from ours. This court will, of course, in construing the instrument by which the Biwabic Company held title, be governed not by the laws of Minnesota but by general law, otherwise the Act of Congress would mean one thing in one state and another thing in each other state depending upon local decisions.

The Independence Mining Company case was decided upon certain questions certified to this Court upon such a state of fact as excluded all chance of "income" from the business of mining.

The Baltic Mining Company case involved the 1913 Act of Congress and was attacked as unconstitutional among other things, because the depletion of five per cent. there authorized, was insufficient to give full de-

pletion and in effect took the capital of the corporation. As to mining companies that Act was sustained as an excise law under the authority of the Independence Mining Company case.

I have already pointed out the reason why the full allowance for the value of all capital assets allowed by the Treasury Department under the Act of 1909 came to be limited to five per cent. in the Act of 1913. I fail to see how the Baltic case is in point. The depletion permitted by that law was specific and definite, and left nothing for construction, and the only question was the constitutionality of the law.

In all three of these cases the apparent injustice to mining corporations is recognized and commented on by this Court. They should not be extended.

Very respectfully submitted,

A. C. Dustin.

# UNITED STATES v. BIWABIK MINING COMPANY.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

No. 504. Argued March 4, 5, 6, 1918.—Decided May 20, 1918.

In computing the excise, under the Corporation Tax Act of August 5, 1909, of a mining company operating under a lease terminable at its option in any year and which grants it the privilege of entering, and of exploring for, mining and removing ores, in return for a royalty of so much per ton removed, but which does not convey the ore in situ, that part of the value of the ore disposed of during the tax year which represents its value as ore in place when the law took effect should not be deducted as depreciation of capital assets. *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503.

The lease here involved is not to be construed as a conveyance of the ore in place, although the latter could be measured with substantial accuracy.

242 Fed. Rep. 9, reversed.

THE case is stated in the opinion.

*The Solicitor General*, with whom *Mr. Wm. C. Herron* was on the brief, for the United States.

*Mr. A. C. Dustin* for respondent, besides dealing with the distinction to be drawn between income and a mere conversion of capital assets existent before the law took effect, presented the following on the nature of the company's interest:

It is said the Biwabik Mining Company's interest in this property was obtained under a lease and that as such lessee it was not the *owner* of the *ore*, and was not, therefore, when it sold the ore converting its capital assets into money. Whether these contracts of lease effected an *absolute* sale of the ore or not is wholly immaterial. It is

settled that they do create an interest in real estate of a permanent character which cannot be divested so long as the contract provisions are complied with. Such a lease is recognised as property and is frequently sold and dealt in in the same way as other property. In 1898 the defendant paid $612,000 for this lease, which was on January 1, 1909, of the agreed value of $3,351,412.81. That a lessee of a mine has a vested estate is well settled.

The position of the Government is in effect that the interest is a mere license to take the ore on payment of the 30 cents per ton. The distinction between such an estate as we have here and a mere license is well recognised. Snyder on Mines, vol. II, §§ 1143, 1390, 1394, 1397; *Wheeler* v. *West*, 71 California, 126, 129; *Boone* v. *Stover*, 66 Missouri, 430, 434; *Barnsdall* v. *Gas Company*, 225 Pa. St. 333; *Coltness Iron Co.* v. *Black*, 6 App. Cas. 315, 335; *Stoughton's Appeal*, 88 Pa. St. 198, 201, 202; *Scranton* v. *Phillips*, 94 Pa. St. 15, 22; *Eley's Appeal*, 103 Pa. St. 300; *Delaware, Lackawanna & Western R. R. Co.* v. *Sanderson*, 109 Pa. St. 583.

The court below distinguishes this case from the *Sargent Land Company Case* in this court, pointing out that royalties could very properly be treated as simply rentals so far as the lessor is concerned; the use of the land for mining purposes being only one of the many uses to which such land could be put, the land itself being the chief thing. But these reasons do not apply to the case of a lessee whose interest is in the ore, which is susceptible of definite measurement and valuation. This interest is wholly exhausted and consumed as the ore is extracted.

It should not be overlooked that after giving the Biwabik Company full credit for the value of its capital assets thus converted into money there was left a large net income in 1910 upon which it paid the taxes assessed by the Government. The construction adopted by the court simply places the company on a parity with other

corporations. It gives it the benefit of the realization of its capital assets as they existed on January 1, 1909.

The action of Congress in allowing first five per cent. and later in full for the depletion of ores, when it came to replace the original corporation tax by the Acts of 1913 and 1916, successively, was an acceptance in principle of the interpretation placed upon the Act of 1909 by the Treasury Department, and reflexly shows what that act itself intended. All the income tax laws are part of a system and cast light one upon another.

The *Sargent Land Company Case*, and *Stratton's Independence* v. *Howbert*, 231 U. S. 399, and *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103, are not in point.

*Mr. Robert R. Reed*, by leave of court, filed a brief on behalf of the Investment Bankers' Association of America, as *amicus curiæ*.

MR. JUSTICE DAY delivered the opinion of the court.

This case is here upon a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit. It was instituted by the United States in the District Court of the United States for the Northern District of Ohio to recover the sum of $2,653.72 being 1% upon $265,372.08 which, it was claimed, the mining company had wrongfully omitted from the return of its net income for the year 1910 under the Corporation Tax Act of 1909.

The case was tried upon an agreed statement of facts which, omitting unnecessary details, were epitomized by the District Court as follows:

"In the year 1906 the defendant, by assignment of a lease, acquired a leasehold estate in certain ore producing properties in the State of Minnesota, from which it mined ore from that date to and including the year 1910. For the year 1910 the defendant made a return to the collector

of internal revenue of its gross income, and from this amount it deducted, 'to cover realization of unearned increment,' the sum of $265,372.08. The amount of this deduction was arrived at by multiplying the number of tons of ore mined during the year by 48¼c., which was the market value of the ore in place on the premises on the first day of January, 1909, as estimated by the defendant, this being the date upon which the returns for taxation were to commence. It is stipulated that this deduction was made in good faith upon the claim that it was 'a reasonable allowance for depreciation' of the property of the defendant for that year.

"In June, 1911, payment was made in accordance with this return, but the Treasury Department about the month of October, 1914, after investigating the books and records of the defendant, made the claim that because the defendant was not the owner in fee of the premises from which it was mining ore, but was lessee of the same and was paying a royalty to the fee owners, it was not entitled to deduct anything for depletion of the ore body on the premises. Thereupon the defendant was requested to amend its return for the year 1910 so as to include in its gross income the amount of said deduction, which it declined to do, and thereupon this suit was instituted to recover the tax upon the amount of this deduction, amounting to $2,653.72.

"Some time prior to the making of the return for the year 1910 the defendant estimated the tonnage and the market value of the ore in place upon the premises upon which it held its lease, which estimate gave to the ore in place a value of 48¼c. per ton, exclusive of royalty.

"The rights of the defendant in the iron ore mined in the year 1910 were derived from the assignment to it of a written lease dated April 4, 1898, by the Biwabik Bessemer Company, lessor. By the terms of that lease the defendant acquired the right for the term of fifty years

and three months from the first day of May, 1898, to explore for, mine out, and remove the merchantable shipping iron ore which might be found upon the lands described in the lease upon the payment of a royalty of 30c. for each ton mined. The expression 'merchantable ore' is defined as including 'all ores which grade 55% and above in metallic iron regardless of other ingredients.'

"The lessee contracted to mine and remove at least 300,000 tons of ore annually, or to pay to the lessor 30c. per ton on that amount if it should not be mined, but payments made in any year in excess of royalty on ore actually mined could be credited upon the excess which might be mined over the minimum requirement in subsequent years. Any failure to keep or perform any of the covenants or conditions of the lease gave to the lessor the option to take immediate possession of the premises.

"The lessor in the lease reserved a lien upon any ore mined and upon all improvements for any unpaid balance of royalty, and it was also provided in the lease that the lessee should have the right to terminate the lease on any first day of January during its term by giving ninety days' notice of the purpose and desire so to do.

"The defendant, at the time it acquired this lease, paid to the prior lessee the sum of $612,000, in addition to contracting to pay the 30c. per ton royalty upon the ore mined, as has been stated.

"It is stipulated in the agreed statement of facts that the deposit of ore on the leased premises is of such character that its quality and quantity were capable of determination 'with extraordinary accuracy' by drilling and shafts, and that the defendant 'by drilling and by standard recognized methods' had calculated the tonnage remaining on the land on January 1, 1909, as 6,874,605 tons, all of which could be easily removed within the term of the lease."

Upon these facts the District Court reached the con-

clusion that the leases in question were not conveyances of ore in place, but were grants of the privilege of entering upon the premises and mining and removing the ore, and, consequently, that the deduction claimed as being one from capital investment could not be allowed. In reaching this conclusion the court cited the opinion of this court in *Stratton's Independence* v. *Howbert*, 231 U. S. 399, and the judgment of the Circuit Court of Appeals for the Eighth Circuit (211 Fed. Rep. 1023) affirming the judgment of the District Court (207 Fed. Rep. 419), which decision of the Circuit Court of Appeals was made after the return of the answer to the questions propounded by that court to this court in the *Stratton's Independence Case*.

Coming to the question as to what allowance should be made to the mining company by way of deduction from its income in making return the district judge said:

"The defendant paid $612,000 for the lease under consideration and in addition assumed the payment of the royalties stipulated for therein. This may properly and justly be considered a payment in advance of an increased royalty on ore to be mined, and that is precisely the character which the defendant gave to the payment when dealing with it in its private accounts, in which the stipulation shows, 'Ex. H,' that it carried one account, entitled 'Rate of general ledger or capitalized value .03885 per ton,' and another account entitled 'Rate of increment value, January 1, 1909, .44865 per ton.' These two values added make the 48¾c. per ton which the defendant deducted in making its return.

"Thus in its own bookkeeping the defendant gives its private opinion as to the requisite reimbursement necessary to maintain its capital investment, and thereby is made applicable that long-standing rule for the construction of contracts, viz., 'Show me what men have done under a contract and I will tell you what it means.' The defendant should not complain if it be held to that

construction of this lease and its investment under it which it adopted for purposes of its own accounting before the question of taxation had arisen to call forth ingenuity of interpretation.

"It results that a decree will be entered allowing instead of the deduction computed on the basis of 48.75 cents per ton of ore mined, the sum of .03885 cents per ton, and there being no question of bad faith in the case, the ends of justice will be served by the payment of interest at the rate of 6% per annum from the date when the additional payment found due should have been made."

The District Court thereupon entered judgment:

"And the court finds as conclusions of law from said facts that the defendant was entitled to deduct for and on account of the 544,353 tons of iron ore mined by it under its lease in the year 1910, the sum of .03885 cents per ton (which amount the parties agree hereby is the cost to defendant of said ore at the time it acquired the property in the year 1898, interest, taxes, surveys, and other carrying charges on the said ore up to the time of its removal from the said mine having been charged annually including the year 1910 into operating expenses), and defendant is not entitled to deduct the 48.75 cents per ton deducted by it in its return, and there is due from the defendant to the plaintiff the sum of $2,442.23, with interest thereon at 6% from the 30th day of June, 1911, the date when said sum should have been paid, and the court assesses the plaintiff's damages herein at $3,140.70, and judgment is hereby rendered against the defendant in favor of the plaintiff of the sum of $3,140.70, with interest from the first day of this term of court."

The company took the case to the Circuit Court of Appeals upon writ of error, that court reversed the judgment of the District Court, holding that the company was entitled to the deduction of 48.75 cents per ton upon each ton of ore mined, as so much depletion of capital assets.

(242 Fed. Rep. 9.) This conclusion was reached upon a construction of the lease in view of the character of the mining property involved, and largely because of the fact that the quantity of the ore in place could be estimated with substantial accuracy. The court held that the selling price of the ore in any one year so far as it represented the actual value to the mining company of the ore in the ground on January 1, 1909, was not income within the meaning of the Corporation Tax Act of 1909. In the course of its opinion the Circuit Court of Appeals announced the decisive question of law to be: "So far as the selling price of the ore in 1910 represented its actual value to the company in the ground on January 1, 1909, was it income or was it the sale price of capital assets?" And after dealing with the character of this lease and the property covered by it, said:

"We think that the lessee of such property and under such a lease is as much entitled as is the owner of the fee to treat the value of his interest in the ore in the ground at the beginning of the tax period as his capital—indeed, the lessee's right to do so, is, in some respects, the stronger of the two, as hereafter pointed out. Such a lease, as applied to this situation, is in every substantial way *pro tanto* a purchase."

This view of the character of these instruments and their legal effect differs from that taken by this court in the *Sargent Land Co. Case*, 242 U. S. 503, wherein precisely similar iron ore leases were under consideration. In that case this court reached the conclusion that such leases were not conveyances of the ore in place, but were grants of the privilege of entering upon, discovering, and developing and removing the minerals from the land, and that the lessor's income from such operations was obtained by a corporation shown to be carrying on business, and upon principles laid down in previous cases in this court (*Stratton's Independence* v. *Howbert*, *supra*; *Stanton*

v. *Baltic Mining Co.*, 240 U. S. 103) that such income was subject to taxation under the Corporation Tax Act of 1909.

In the *Sargent Land Co. Case* it was pointed out that the courts of Minnesota, certainly familiar with the physical characteristics of the ore deposits involved, had in a series of cases held these instruments to be leases, and that the royalties agreed to be paid were rentals in compensation for the privileges granted the lessee. We held the conclusion of the Minnesota courts to be warranted by reason and authority. (242 U. S. 503, and cases cited in margin, p. 518.)

The Circuit Court of Appeals distinguished the *Sargent Land Co. Case*, and of it said:

"Finally, it is urged that this case is controlled by the decision of the Supreme Court in the *Sargent Land Company Case*. The mining leases involved in that case and in this one seem to be identical in substance, and it is now said with great plausibility that the ore in the ground and affected by such a lease belongs partly to the lessor and partly to the lessee, and that if the interest of the lessor is not capital assets no more is the interest of the lessee, and that if the receipts of the former are income so must those of the latter be. We are convinced that the analogy between the two cases is superficial and not substantial. In that case the Supreme Court had to determine whether the royalties received by the lessor were income or were a depletion of capital. Many considerations led to the conclusion that they must be treated as income. The contract was a 'lease,' the receipts were 'royalties,' and royalties being rentals are inherently income and have been commonly so considered. All these things seem to have affected the conclusion of the court, but after all the dominating thought appears to be that when land is devoted to mining it is put to only one of those productive uses of which it is capable, and that the product of

the use should be called income. The land itself is the chief thing. After the mining is finished the land remains suitable for other uses; and the fact, if it is a fact, that the minerals are the greater part of its value can not operate to make the incidental overshadow the principal. These reasons do not apply at all to the case of the lessee, whose existing interest, at the beginning of the taxing period, over and above the royalty which he must pay, amounted to $3,000,000; his entire interest was each year, as far as he went, consumed and exhausted forever; he did not have remaining the principal thing, the land, which he could put to some other use; the receipt in 1910 of his January 1st, 1909, interest in the ore was not the offshoot and income of his property; it was the transformation and eating up of the very property and of the whole of it. We therefore think that applying the principle of the *Sargent Case* results in holding that these receipts were from the sale of capital assets and not from income."

We are unable to concur in this view expressed in the opinion of the Circuit Court of Appeals as to the effect of the *Sargent Land Co. Case*. Certainly this court had not in mind the distinction suggested. In the *Sargent Land Co. Case* the Circuit Court of Appeals for the Eighth Circuit found that the land including the ore in it was worth hundreds of thousands of dollars, and without the right to the ore the land was worth practically nothing. (219 Fed. Rep. 38.) This finding, as well as facts of general knowledge, leaves little room to suppose that this court made its decision concerning the rights of the lessor influenced by the fact that the land itself was the chief thing, and the ownership of it after the exhaustion of the minerals one of the controlling reasons in reaching the conclusion announced in that case. The lessee takes from the property the ore mined, paying for the privilege so much per ton for each ton removed. He has this right or privilege under the form of lease here involved so long as

he sees fit to hold the same without exercising the privilege of cancellation therein contained. He is, as we held in the *Sargent Land Co. Case*, in no legal sense a purchaser of ore in place.

In this case the Government took no writ of error as to the partial deduction allowed by the District Court; it follows that the correctness of that ruling is not open here. The Circuit Court of Appeals erred in making the additional allowance for capital depletion. It follows that the judgment of the Circuit Court of Appeals must be reversed, and that of the District Court affirmed, and it is so ordered.

*Reversed.*

MR. JUSTICE CLARKE took no part in the consideration or decision of this case.